PRELIMINARY OFFICIAL STATEMENT DATED JUNE 11, 2007

NEW ISSUE—BOOK-ENTRY ONLY

Ratings:
Moody's: A1
S&P: A+
Fitch: A+
(See "RATINGS" herein)

In the opinion of Co-Bond Counsel to the State of California (the "State"), interest on the Bonds is excluded from gross income for federal income tax purposes and exempt from State personal income taxes, all as further discussed in "TAX MATTERS" herein.

$2,500,000,000*
STATE OF CALIFORNIA
VARIOUS PURPOSE GENERAL OBLIGATION BONDS

Dated: June 1, 2007 **Due: June 1, as shown on the inside cover page**

Interest on the Bonds is payable on June 1 and December 1 of each year, commencing on December 1, 2007. The Bonds of each maturity will bear interest from their dated date to their maturity or prior redemption at the respective rates set forth on the inside cover page hereof. Bonds may be purchased in book-entry form only, in the principal amount of $5,000 or any integral multiple thereof. See "THE BONDS—General" and APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM."

Certain of the Bonds are subject to redemption prior to their stated maturities, as described herein. See "THE BONDS—Redemption Provisions."

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS."

This cover page contains certain information for general reference only. It is not a summary of the security or terms of this issue. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed investment decision.

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES,
PRICES OR YIELDS AND CUSIPS
(See Inside Front Cover)

The Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of validity by the Honorable Edmund G. Brown Jr., Attorney General of the State, and by Orrick, Herrington & Sutcliffe LLP and by Lofton & Jennings, Co-Bond Counsel to the State. Orrick, Herrington & Sutcliffe LLP served as Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Gibbs & Oliphant LLP. Public Resources Advisory Group served as the Financial Advisor to the State. The Bonds are expected to be available for delivery on or about June 28, 2007.

HONORABLE BILL LOCKYER
Treasurer of the State of California

Citi

Banc of America Securities LLC **E. J. De La Rosa & Co., Inc.** **Fidelity Capital Markets Services**

Alamo Capital	**Alta Capital Group**	**Backstrom McCarley Berry & Co., LLC**
Bear, Stearns & Co. Inc.	**Comerica Securities**	**Crocker Securities, LLC**
Goldman, Sachs & Co.	**Great Pacific Securities**	**Grigsby & Associates, Inc.**
JPMorgan	**Henderson Capital Partners, LLC**	**Lehman Brothers**
Merrill Lynch & Co.	**Morgan Stanley & Co. Incorporated**	**RBC Capital Markets**
Ramirez & Co., Inc.	**Siebert Brandford Shank & Co., LLC**	**Stone & Youngberg LLC**
UBS Securities LLC	**Wedbush Morgan Securities**	**Wells Fargo Insitutional Securities, LLC**

Official Statement Dated: June __, 2007.

* Preliminary, subject to change.

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES OR YIELDS AND CUSIPS†

$2,500,000,000*
STATE OF CALIFORNIA
VARIOUS PURPOSE GENERAL OBLIGATION BONDS

Base CUSIP†:

Maturity Date (June 1)	Principal Amount*	Interest Rate	Price or Yield	CUSIP†	Maturity Date (June 1)	Principal Amount*	Interest Rate	Price or Yield	CUSIP†
2008	$38,145,000				2023	$77,500,000			
2009	42,765,000				2024	81,375,000			
2010	44,475,000				2025	85,445,000			
2011	46,255,000				2026	89,720,000			
2012	48,105,000				2027	94,205,000			
2013	50,030,000				2028	98,915,000			
2014	52,030,000				2029	103,860,000			
2015	54,175,000				2030	109,055,000			
2016	56,410,000				2031	114,505,000			
2017	58,810,000				2032	120,230,000			
2018	61,305,000				2033	126,240,000			
2019	64,065,000				2034	132,555,000			
2020	66,950,000				2035	139,180,000			
2021	70,295,000				2036	146,140,000			
2022	73,810,000				2037	153,450,000			

(Plus accrued interest from June 1, 2007)

* Preliminary, subject to change.

No dealer, broker, salesperson or other person has been authorized by the State or the Underwriters to give any information or to make any representations with respect to the State or its Bonds other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. The information set forth herein has been obtained from sources which are believed to be current and/or reliable. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the summarized documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

This Preliminary Official Statement is not to be construed as a contract with the purchasers of the Bonds.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as a part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE INSIDE FRONT COVER HEREOF, AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS CONTAINED IN SUCH ACT. THE BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.

Copies of this Preliminary Official Statement may be obtained from:

HONORABLE BILL LOCKYER
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
1-800-900-3873

This Preliminary Official Statement is available as public information on the State Treasurer's Internet site at http://www.treasurer.ca.gov.

(THIS PAGE INTENTIONALLY LEFT BLANK)

TABLE OF CONTENTS

(THIS PAGE INTENTIONALLY LEFT BLANK)

OFFICIAL STATEMENT
$2,500,000,000*

STATE OF CALIFORNIA

VARIOUS PURPOSE GENERAL OBLIGATION BONDS

INTRODUCTION

This Introduction contains only a brief summary of the terms of the Bonds and a brief description of this Official Statement; a full review should be made of the entire Official Statement, including the Appendices and the financial statements incorporated by reference herein. Summaries of provisions of the Constitution and laws of the State of California (the "State") or any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.

Description of the Bonds

This Official Statement presents certain information relating to the State in connection with the sale of $2,500,000,000* aggregate principal amount of State general obligation bonds comprised of up to ten series of bonds (the "Bonds"). See "THE BONDS—Identification and Authorization of the Bonds."

The Bonds will be registered in the name of a nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only, in denominations of $5,000 or any integral multiple thereof. See "THE BONDS—General" and APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM."

The issuance of each series of the Bonds is authorized by the respective general obligation bond act (collectively, the "Bond Acts") relating thereto approved by the voters of the State and by resolutions of applicable finance committees (the "Resolutions") created or designated under the Bond Acts. The Bonds are being issued to current refund outstanding State general obligation commercial paper notes, repay interim loans from the State's Pooled Money Investment Account that financed various projects under the respective Bond Acts, finance various projects under the respective Bond Acts and pay certain costs of issuance of the Bonds. See "THE BONDS—Purposes of the Bonds."

Security and Source of Payment for the Bonds

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Security." Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from moneys in the General Fund of the State Treasury (the "General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A—"THE STATE OF CALIFORNIA—STATE FINANCES—The General Fund" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds." The Bond Acts authorizing the Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Bonds.

---

*Preliminary, subject to change.

Redemption

The Bonds of certain maturities will be subject to optional redemption prior to their respective stated maturity dates, in whole or in part, and to mandatory redemption prior to their respective stated maturities, in part, from sinking fund payments made by the State. See “THE BONDS—Redemption Provisions.”

Information Related to this Official Statement

The information set forth herein has been obtained from official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder or any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

All financial and other information presented or incorporated by reference in this Official Statement has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of certain information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. However, certain statements included or incorporated by reference in this Official Statement do constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Any statements made in this Official Statement involving matters of opinion, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications and State agency websites. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted in the section herein titled “FINANCIAL STATEMENTS” and in APPENDIX A—“THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS.”

The information in APPENDIX B—“DTC AND THE BOOK-ENTRY SYSTEM” has been furnished by DTC and no representation is made by the State or the Underwriters or the Financial Advisor as to the accuracy or completeness of such information.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State. This Official Statement is not to be construed as a contract with the purchasers of the Bonds.

This Official Statement does not constitute an offer to sell the Bonds or the solicitation of an offer to buy, nor shall there be any sale of, the Bonds by any person in any state or other jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale in such state or jurisdiction.

Continuing Disclosure

The State Treasurer will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which any Bonds are outstanding (the "Annual Report"), commencing with the report to be filed on or before April 1, 2008 containing 2006-07 Fiscal Year financial information, and to provide notice of the occurrence of certain enumerated events if material. The specific nature of the information to be contained in the Annual Report and the notices of material events and certain other terms of the continuing disclosure obligation are set forth in APPENDIX C—"FORM OF CONTINUING DISCLOSURE CERTIFICATE."

The State has not failed to comply, in all material respects, with any "previous undertakings," as that term is used in Rule 15c2-12 (the "Rule") promulgated under the Securities and Exchange Act of 1934, as amended.

AUTHORIZATION OF AND SECURITY FOR THE BONDS

Authorization

Each Bond Act and the State General Obligation Bond Law (the "Law") in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code as incorporated by reference into each Bond Act provides for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds. The Bonds are authorized under each Bond Act by a resolution adopted by a finance committee created or designated in such Bond Act.

Security

The Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The Bond Acts provide that the State will collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and interest on the Bonds as they become due and payable. It is an event of default of the State to fail to pay or to fail to cause to be paid the principal of or interest on the Bonds when due or to declare a moratorium on the payment of, or to repudiate, any Bond.

The full faith and credit of the State are pledged for the punctual payment of the principal of and the interest on the Bonds. All payments of principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, have an equal claim to the General Fund, subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A—"THE STATE OF CALIFORNIA—STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds."

Remedies

It is an event of default of the State under the Resolutions authorizing the Bonds pursuant to the respective Bond Acts to fail to pay or to fail to cause to be paid, when due, or to declare a moratorium on the payment of, or to repudiate any Bond.

In case one or more events of default occurs, then and in every such case the registered Bondholder is entitled to proceed to protect and enforce such registered Bondholder's rights by such appropriate judicial proceeding as such registered Bondholder deems most effective to protect and enforce any such right, whether by mandamus or other suit or proceeding at law or in equity, for the specific performance of any covenant or agreement contained in the Resolutions authorizing the Bonds, as more specifically set forth in the Resolutions authorizing the Bonds pursuant to the respective Bond Acts. Beneficial owners of the Bonds (the "Beneficial Owners") cannot protect and enforce such rights except through the registered Bondholder (as defined in the related Resolution). See "THE BONDS—General," and APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM."

THE BONDS

General

The Bonds will be registered in the name of a nominee of DTC, which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only in denominations of $5,000 or any integral multiple thereof. See APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM." The information in APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM" has been furnished by DTC and no representation is made by the State, the Financial Advisor or the Underwriters as to the accuracy or completeness of such information.

Neither the State Treasurer nor the Underwriters can or does give any assurances that DTC will distribute to Participants, or that Direct Participants or Indirect Participants (as defined in APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM") or others will distribute to the Beneficial Owners, payment of principal of and interest on the Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. Neither the State Treasurer nor the Underwriters is responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Bonds or any error or delay relating thereto.

The Bonds will be dated June 1, 2007, and will mature on June 1 of the years and in the amounts set forth on the inside cover page hereof. Interest on the Bonds is payable on June 1 and December 1 in each year (each, an "Interest Payment Date"), commencing on December 1, 2007, at the rates shown on the inside cover page of this Official Statement. Interest on the Bonds will be calculated on the basis of a 360-day year comprising twelve 30-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the Participants in DTC for disbursement to the Beneficial Owners of the Bonds. The record date for the payment of interest on the Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

Identification and Authorization of the Bonds*

The Bonds are being issued to current refund certain outstanding State general obligation commercial paper notes (the "Notes") issued to finance various projects under the respective Bond Acts identified below, repay interim loans from the State's Pooled Money Investment Account that financed various projects under the respective Bond Acts identified below, finance various projects under the

*Preliminary, subject to change.

respective Bond Acts identified below and pay certain costs of issuance of the Bonds. The Notes will be repaid within 90 days after the issuance of the Bonds so as to constitute a "current refunding" for federal tax purposes The Bonds are issued as ten separate series under eight separate Bond Acts, each authorized by the voters, as set forth below:

- $157,115,000* principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds, Series X, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (the Villaraigosa-Keeley Act).

- $20,385,000* principal amount of State of California Library Construction and Renovation Bonds, Series K, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

- $176,840,000* principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series AC, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

- $17,490,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series AE, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $115,130,000* principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds, Series N, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

- $230,020,000* principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds, Series L, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

- $55,905,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series AF, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $242,055,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series S, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

- $1,450,060,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series R, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

- $35,000,000* principal amount of State of California Children's Hospital Bonds, Series D, authorized by the Children's Hospital Bond Act Finance Committee under the Children's Hospital Bond Act of 2004.

---

*Preliminary, subject to change.

Purposes of the Bonds

The proceeds of the Bonds, after costs of issuance, are being used to finance or refinance capital facilities for public purposes including acquisition, construction and improvement of children's hospitals, public libraries, local public schools, higher education facilities, water safety, security and reliability, and protection and restoration of parks, wildlife, coastal resources and recreational facilities. Proceeds will also be used, in some cases, for costs of program operation at both the State and local levels.

Redemption Provisions*

Optional Redemption

The Bonds maturing on or before June 1, 20__ are not subject to optional redemption prior to their respective stated maturities. The Bonds maturing on and after June 1, 20__ are subject to optional redemption prior to their respective stated maturity dates, in whole or in part, in such order of maturity as may be designated by the State Treasurer and by lot within any maturity, on any date on or after June 1, 20___ at a redemption price equal to 100% of the principal amount thereof, without premium, plus accrued interest to the date fixed for redemption.

Sinking Fund Redemption

The Bonds maturing on June 1, 20__ (the "Term Bonds") are subject to redemption prior to their stated maturity date, in part, from sinking fund payments made by the State, at a redemption price of 100% of the principal amount thereof, plus accrued interest to the sinking fund payment date fixed for redemption, without premium, on June 1 of the years, and in the amounts designated below for the Bonds:

Term Bonds Due June 1, 20__

Sinking Fund Payment Date (June 1)	Principal Amount Redeemed
†	

† Final Maturity

If a Term Bond is called for optional redemption in part (see "Optional Redemption" above), the remaining sinking fund installments for such Term Bonds shall be adjusted as determined by the State Treasurer.

Notice of Redemption

When redemption is required while the Bonds are in book-entry form, the State Treasurer is to give notice of redemption by mailing copies of such notice only to DTC (not to the Beneficial Owners of the Bonds) not less than 30 or more than 60 days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the Beneficial Owners of the Bonds.

*Preliminary, subject to change.

See APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM." The notice from the State Treasurer will state, among other things, that the Bonds or a designated portion thereof (in the case of partial redemption of a Bond) are to be redeemed, the dated date of the Bonds, the date fixed for redemption, the maturities of the Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption no further interest will accrue on the principal of any Bonds called for redemption. The notice of redemption may also state that such redemption may be cancelled in whole or in part by the State Treasurer upon written notice to DTC no later than five business days prior to the date fixed for redemption. Notice of redemption will also be provided by mail to certain financial information services and securities depositories.

(REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK)

Annual Debt Service Requirements

The following table sets forth the amounts required to be made available for the payment of principal (whether at maturity or by sinking fund payments), interest and the total payments due on the Bonds.

Fiscal Year Ended June 30	**Principal**	**Interest**	**Fiscal Year Total Debt Service**
2008	$	$	$
2009			
2010			
2011			
2012			
2013			
2014			
2015			
2016			
2017			
2018			
2019			
2020			
2021			
2022			
2023			
2024			
2025			
2026			
2027			
2028			
2029			
2030			
2031			
2032			
2033			
2034			
2035			
2036			
2037			
Total	$	$	$

Supplemental Resolutions

The State may modify or amend the Resolutions with respect to any outstanding Bonds and the rights and obligations of the Bondholders of such outstanding Bonds and the State at any time by a Supplemental Resolution, without notice to or the consent of any Bondholder, but only to make such provisions for the purpose of (i) curing any ambiguity, curing, correcting or supplementing any defective provision contained in the Resolutions, or (ii) complying with requirements of the Internal Revenue Code of 1986, as amended (the "Code") in order to satisfy the covenants of the Resolutions relating to tax exemption of interest on the Bonds; in each case as the respective finance committee may deem necessary or desirable and not inconsistent with the Resolutions, and which shall not adversely affect the interests of the Bondholders holding the affected Bonds.

Defeasance

Pursuant to the Bond Acts and the provisions of California Government Code Section 16780 *et seq.* (the "Refunding Law"), refunding bonds may be issued to refund outstanding Bonds at or prior to their stated maturity. Pursuant to Section 16784 of the Refunding Law, the proceeds of such refunding bonds shall be deposited into the Refunding Escrow Fund of the State Treasury, which Fund is irrevocably dedicated to pay the principal of, premium, if any, and interest on the refunded Bonds as it comes due. If Defeasance Obligations sufficient to pay all of the principal of, premium, if any, and interest on the refunded Bonds to their maturity or the date fixed for redemption are so deposited in the Refunding Escrow Fund, the refunded Bonds will no longer be deemed outstanding for purposes of the Resolutions. Except in the case of the defeasance of Bonds by the deposit of the full amount of the principal and interest due until redemption or maturity, the sufficiency of the deposit in the Fund will be verified by a firm of independent public accountants.

The Resolutions relating to the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (the Villaraigosa-Keeley Act), the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000,the Kindergarten-University Public Education Facilities Bond Act of 2002, the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002, the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 and the Kindergarten-University Public Education Facilities Bond Act of 2004 (see "THE BONDS—Identification and Authorization of Bonds" above) specifically define "Defeasance Obligations" for these purposes as follows: (i) bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest, including receipts, certificates or any other evidences of an ownership interest in (i) or in specified portions thereof, which are rated in the highest rating category by each rating agency rating such obligations; (ii) bonds or interest-bearing notes or obligations that are guaranteed as to principal and interest by a federal agency of the United States; (iii) pre-refunded municipal bonds which are rated in the highest rating category by each rating agency rating such bonds; (iv) bonds, consolidated bonds, collateral trust debentures, consolidated debentures or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended; debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended; bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act; bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act as amended and bonds of any federal home loan bank established under that act; obligations of the Federal Home Loan Mortgage Corporation; bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended; and bonds, notes and other obligations guaranteed by the Commodity Credit Corporation for the export of California agricultural products under the Commodity Credit Corporation Charter Act as amended, provided, however that the Defeasance Obligations specified in this paragraph (iv) shall be rated by at least two of any three rating agencies rating such obligations not lower than the higher of (1) the rating on the Bonds to be defeased at the time of the original issuance thereof and (2) the rating on the Bonds to be defeased at the time of defeasance; (v) deposit in the State Surplus Money Investment Fund; or (vi) any other investment designated in a Supplemental Certificate as a Defeasance Obligation for purposes of defeasing the Bonds authorized by such Supplemental Certificate, provided that each rating agency has confirmed in writing to the Treasurer that the use of such other investment will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such rating agency with respect to any such Bonds defeased.

LEGAL MATTERS

The opinion of the Honorable Edmund G. Brown Jr., Attorney General of the State of California (the "Attorney General"), approving the validity of the Bonds will accompany the Bonds deposited with DTC. The opinions of Orrick, Herrington & Sutcliffe LLP and Lofton & Jennings, Co-Bond Counsel to the State, approving the validity of the Bonds and addressing certain tax matters will also accompany the Bonds deposited with DTC. The proposed forms of legal opinions for the Bonds are set forth in APPENDIX D. See "TAX MATTERS" and APPENDIX D—"PROPOSED FORMS OF LEGAL OPINIONS." Orrick, Herrington & Sutcliffe LLP served as Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Gibbs & Oliphant LLP.

The Attorney General, Co-Bond Counsel and Underwriters' Counsel, respectively, undertake no responsibility for the accuracy, completeness or fairness of this Official Statement.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP and Lofton & Jennings, Co-Bond Counsel to the State, based upon an analysis of existing laws, regulations, rulings, and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Code and is exempt from State of California personal income taxes. Co-Bond Counsel are of the further opinion that such interest is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Co-Bond Counsel observe that such interest is included in adjusted current earnings when calculating federal corporate alternative minimum taxable income. A complete copy of the proposed form of opinions of Co-Bond Counsel is set forth in APPENDIX D—"PROPOSED FORMS OF LEGAL OPINIONS."

The amount (if any) by which the issue price of the Bonds of any given maturity date is less than the amount to be paid on such date (excluding amounts stated to be interest and payable at least annually over term of such Bonds) constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Bonds which is excluded from gross income for federal income tax purposes and exempt from State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Bonds is the first price at which a substantial amount of such maturity of the Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to Bonds of any maturity date accrues daily over the term to such maturity date on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Bonds. Beneficial Owners of the Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Bonds with original issue discount, including the treatment of purchasers who do not purchase such Bonds in the original offering to the public at the first price which a substantial amount of such Bonds is sold to the public.

Any Bonds purchased, whether at original issuance or otherwise, for an amount greater than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of obligations, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner's basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Bonds. The State has made certain representations and covenanted to comply with certain restrictions, conditions, and requirements designed to ensure that interest on the Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Bonds being included in gross income for federal income tax purposes, possibly from the date of original delivery of the Bonds. Co-Bond Counsel have not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) or any other matters coming to the attention of Co-Bond Counsel after the date of delivery of the Bonds may adversely affect the value of, or the tax status of interest on, the Bonds.

Although Co-Bond Counsel are of the opinion that interest on the Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the Bonds may otherwise affect a beneficial owner's federal or state tax liability. The nature and extent of these other tax consequences will depend upon the particular tax status of the beneficial owner or the beneficial owner's other items of income or deduction. Co-Bond Counsel express no opinion regarding any such other tax consequences.

The opinions of Co-Bond Counsel are based on current legal authority, cover certain matters not directly addressed by such authorities, and represent Co-Bond Counsel's judgment as to the proper treatment of the Bonds for federal income tax purposes. The opinions of Co-Bond Counsel are not binding on the Internal Revenue Service ("IRS") or the courts. Co-Bond Counsel cannot give and have not given any opinion or assurance about the future activities of the State, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or changes in enforcement thereof by the IRS. The State has covenanted, however, to comply with the requirements of the Code.

Co-Bond Counsel's engagement with respect to the Bonds ends with the issuance of the Bonds, and, unless separately engaged, Co-Bond Counsel are not obligated to defend the State or the Beneficial Owners regarding the tax-exempt status of the Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the State and their appointed counsel, including the Beneficial Owners, would have little if any right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the State legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues, may affect the market price for, or the marketability of, the Bonds, and may cause the State or the Beneficial Owners to incur significant expense.

Future legislative proposals, if enacted into law, or clarification of the Code, or court decisions, may cause interest on the Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners of the Bonds from realizing the full current benefit of the tax status of such interest. As one example, on May 21, 2007, the United States Supreme Court agreed to hear an appeal from a Kentucky state court which ruled that the United States Constitution prohibited the state from providing a tax exemption for interest on bonds issued by the state and its political subdivisions but taxing interest on obligations issued by other states and their political subdivisions. The introduction or enactment of any such future legislative proposals or clarification of the Code or court decision may also affect the market price for, or marketability of, the Bonds. Prospective purchasers of the Bonds should consult their own tax advisers regarding any pending or proposed federal or state tax legislation, regulations or litigation, as to which Co-Bond Counsel express no opinion.

LITIGATION

The Attorney General has advised that to his knowledge there is not now pending (with service of process on the State having been accomplished) or threatened any litigation seeking to restrain or enjoin the sale, issuance, execution or delivery of the Bonds or challenging the validity of the Bonds or any proceedings of the State taken with respect to the foregoing.

At any given time, including the present, there are numerous civil actions pending against the State, which could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues and cash flow. While there can be no assurances as to the ultimate outcome and fiscal impact of such litigation, the State believes that it is unlikely that the outcome of any such litigation could adversely affect the ability of the State to pay the principal of and interest on the Bonds when due. See APPENDIX A—"THE STATE OF CALIFORNIA—LITIGATION."

UNDERWRITING

The Bonds are being purchased by Citigroup Global Markets Inc., as representative (the "Representative") of the underwriters listed on the cover page hereof (the "Underwriters"). The Representative has agreed to purchase the Bonds for an aggregate purchase price of $_________ (representing the principal amount of the Bonds of $_________, plus net original issue premium of $_________, less an Underwriters' discount of $_________ plus accrued interest of $_________.) The initial public offering prices of the Bonds may be changed from time to time by the Underwriters.

The Bond Purchase Contract relating to the Bonds provides that (i) the Underwriters will purchase all of the Bonds if any of the Bonds are purchased and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

FINANCIAL STATEMENTS

Audited Basic Financial Statements of the State of California (the "Financial Statements") are available for the Year ended June 30, 2006. These statements have been examined by the State Auditor to the extent indicated in her report. Such Financial Statements have been filed with all of the Nationally Recognized Municipal Securities Information Repositories, as part of an Official Statement dated March 28, 2007 for $4,096,410,000 State General Obligation Refunding Bonds, and are incorporated by reference into this Official Statement. The Financial Statements are also available through electronic means. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See APPENDIX A—"THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS" for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the ten months ended April 30, 2007 are included as Exhibit 1 to APPENDIX A. See APPENDIX A–"EXHIBIT 1—STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006 THROUGH APRIL 30, 2007 (UNAUDITED)."

RATINGS

The Bonds have received the ratings of "A1" by Moody's Investors Service, "A+" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc., and "A+" by Fitch Ratings. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. Any revision or withdrawal of a credit rating could have an effect on the market prices and marketability of the Bonds. The State cannot predict the timing or impact of future actions by the rating agencies. See APPENDIX A—"THE STATE OF CALIFORNIA—INTRODUCTION TO APPENDIX A—California's Credit and Rating History."

FINANCIAL ADVISOR

Public Resources Advisory Group served as the Financial Advisor to the State in connection with the issuance of the Bonds. The Financial Advisor has not been engaged, nor has it undertaken, to make an independent verification or assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement.

ADDITIONAL INFORMATION

The State Treasurer will execute a certificate upon delivery of the Bonds to the effect that, to the best of the State Treasurer's knowledge, information and belief, as of the delivery date, the information and statements contained in this Official Statement are complete, true and correct in all material respects and this Official Statement does not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

STATE OF CALIFORNIA
BILL LOCKYER
Treasurer of the State of California

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX A

THE STATE OF CALIFORNIA

Honorable Bill Lockyer

Treasurer of the State of California

TABLE OF CONTENTS

Page

INTRODUCTION TO APPENDIX A

Importance of APPENDIX A. APPENDIX A is the part of the Official Statement that provides investors with information concerning the State of California. Investors are advised to read the entire Official Statement, including APPENDIX A, to obtain information essential to making an informed investment decision. Certain abbreviations and defined terms are shown at the end of this Introduction.

Payment Priority of General Obligation Bonds. The Bonds are general obligations of the state to which the full faith and credit of the state are pledged. Principal of, premium, if any, and interest on all state general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the state, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education.

California's Credit and Rating History. California has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

After reaching their lowest point in 2003, the ratings of the state's general obligation bonds have been raised by all three rating agencies starting in 2004 and most recently in Spring, 2006. Standard & Poor's has raised the state's general obligation credit rating from "BBB" to "A+." Moody's has raised the rating from "Baa1" to "A1." Fitch has raised the rating from "BBB" to "A+."

Any revisions or withdrawal of a credit rating could have an effect on the market price and liquidity of the Bonds. The state cannot predict the timing or impact of future actions by the rating agencies. See also "RATINGS" in the forepart of this Official Statement.

Overview of APPENDIX A. Following the Introduction, APPENDIX A begins with a brief summary of recent developments and a description of the types of debt instruments that the state has issued and is authorized to issue in the future. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS." A discussion of the state's current and projected cash flow is contained under "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings."

APPENDIX A continues with a discussion of the sources and uses of state funds. See "STATE FINANCES." The budget process and constraints on this process, as well as the budget proposed by the Governor and the economic assumptions underlying the revenue projections contained in the proposed budget, are discussed under "THE BUDGET PROCESS" and "CURRENT STATE BUDGET."

APPENDIX A incorporates by reference the Audited Basic Financial Statements of the state for the Year Ended June 30, 2006, together with certain information required by governmental accounting and financial reporting standards to be included in the Financial Statements, including a "Management's Discussion and Analysis" that describes and analyzes the financial position of the state and provides an overview of the state's activities for the fiscal year ended June 30, 2006. In addition, APPENDIX A contains the State Controller's unaudited reports of cash receipts and disbursements for the periods after June 30, 2006. See "FINANCIAL STATEMENTS."

Governance, management and employee information is set forth under "OVERVIEW OF STATE GOVERNMENT." Demographic and economic statistical information is included under "ECONOMY AND POPULATION." APPENDIX A concludes with a description of material litigation involving the state (see "LITIGATION") and debt tables (see "STATE DEBT TABLES").

Certain Defined Terms. The following terms and abbreviations are used in this APPENDIX A:

"2004 Budget Act" means the Budget Act for the 2004-05 Fiscal Year, adopted on July 31, 2004.

"2005-06 Governor's Budget" means the Governor's Proposed Budget for the 2005-06 Fiscal Year, released on January 10, 2005.

"2005-06 May Revision" means the May Revision of the 2005-06 Governor's Budget, released on May 13, 2005.

"2005 Budget Act" means the Budget Act for the 2005-06 Fiscal Year, adopted on July 11, 2005.

"2006-07 Governor's Budget" means the Governor's Proposed Budget for the 2006-07 Fiscal Year, released on January 10, 2006.

"2006-07 May Revision" means the May Revision of the 2006-07 Governor's Budget, released on May 12, 2006.

"2006 Budget Act" means the Budget Act for the 2006-07 Fiscal Year, adopted on June 30, 2006.

"2007-08 Governor's Budget" means the Governor's Proposed Budget for the 2007-08 Fiscal Year, released on January 10, 2007.

"2007-08 May Revision" means the May Revision of the 2007-08 Governor's Budget, released on May 14, 2007.

Reference to the "state" as a noun or adjective means the State of California, following the practice of the Department of Finance.

RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES

This section discusses certain significant developments regarding the state's economy or finances which have occurred since the date of the Official Statement, dated March 28, 2007, relating to $4,096,410,000 State of California General Obligation Refunding Bonds. Investors are advised to read this entire Appendix A.

Governor Schwarzenegger released the May Revision to his proposed budget for the 2007-08 Fiscal Year on May 14, 2007. This document contained updated revenue estimates for the 2006-07 and 2007-08 fiscal years, and revisions to the Governor's proposed spending plan for 2007-08. It also contained updated economic forecasts upon which the revenue estimates and budget proposals were based.

General Fund revenues are expected to increase $1.166 billion in 2006-07 and decrease $24 million in 2007-08 compared to the Governor's January budget. These totals reflect transfers to the Budget Stabilization Account of $472 million in 2006-07 and $1.023 billion in 2007-08. The Governor now projects that the total budgetary reserve will be about $2.2 billion at June 30, 2008. The 2007-08 May Revision projects slower economic growth in the nation and in California in calendar 2007 and improved economic growth in 2008 and 2009. See "CURRENT STATE BUDGET – Proposed Fiscal Year 2007-08 Budget" and "—Economic Assumptions."

On May 3, 2007, the Governor signed AB 900 (Chapter 7, Statutes of 2007) ("AB 900"), which provides for a critical expansion of capacity in the state prison system and additional funds for county jails, through the issuance of approximately $7.4 billion of lease-revenue bonds. In addition to construction funding, AB 900 emphasized expanding rehabilitative programs and measuring outcomes through performance goals to reduce the high rate of recidivism among adult offenders. See "CURRENT STATE BUDGET – Strategic Growth Plan – Prison Construction Program."

On May 7, 2007, the State Controller released a report prepared by the actuarial firm Gabriel Roeder Smith & Company which contains an estimate of the actuarial accrued liability of the State as of July 1, 2007 for the payment of health care benefits to present and retired state employees. The results of this report are described below under "PENSION TRUSTS – Post Retirement Benefits."

STATE INDEBTEDNESS AND OTHER OBLIGATIONS

General

The State Treasurer is responsible for the sale of debt obligations of the state and its various authorities and agencies. The state has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

Capital Facilities Financing

General Obligation Bonds

The State Constitution prohibits the creation of general obligation indebtedness of the state unless a bond measure is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "STATE FINANCES—State Expenditures." Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of May 1, 2007, the state had outstanding $49,843,727.123 aggregate principal amount of long-term general obligation bonds, of which $38,894,747,123 were payable primarily from the state's General Fund, and $10,948,980,000 were payable from other revenue sources. See "—Economic Recovery Bonds" below. As of May 1, 2007, there were unused voter authorizations for the future issuance of $70,511,016,000 of long-term general obligation bonds, some of which may first be issued as commercial paper notes (see "Commercial Paper Program" below). Of this unissued amount, $4,278,910,000 is for bonds payable from other revenue sources. See the table "Authorized and Outstanding General Obligation Bonds" following the caption "STATE DEBT TABLES."

General obligation bond law permits the state to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. The state had outstanding $6,740,565,000 variable rate general obligation bonds (which includes the economic recovery bonds), representing about 13.5 percent of the state's total outstanding general obligation bonds as of May 1, 2007.

New General Obligation Bond Measures Approved on November 7, 2006

In response to the Governor's proposal for a $220 billion infrastructure investment plan, which would have used $68 billion in new general obligation bonds, the Legislature approved four bond measures, totaling approximately $37.3 billion, which were all approved by the voters at the November 7, 2006 general election. See "CURRENT STATE BUDGET – California Strategic Growth Plan" below. These four measures are for the following programs:

--- $19,925,000,000 for transportation improvements, air quality and port security (Proposition 1B)

--- $10,416,000,000 for K-12 school modernization and construction ($7.3 billion), and higher education facilities ($3.1 billion) (Proposition 1D)

--- $4,090,000,000 for flood control and prevention, levee repair and similar costs (Proposition 1E)

--- $2,850,000,000 for housing and related programs (Proposition 1C)

An initiative measure (Proposition 84) authorizing approximately $5.4 billion of bonds for water quality, flood control, parks and similar facilities was also approved by the voters. All of these bond measures are included in the tables following the caption "STATE DEBT TABLES."

A $9.95 billion bond measure for high speed rail projects was moved from the November 2006 general election until the 2008 general election. However, the Administration has proposed to defer this bond measure indefinitely. See "CURRENT STATE BUDGET – California Strategic Growth Plan" below.

Commercial Paper Program

Pursuant to legislation enacted in 1995, voter-approved general obligation indebtedness may be issued either as long-term bonds or, for some but not all bond issues, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. It is currently the state's policy to use commercial paper notes for a portion of the interim funding of voter-approved projects. (The balance of such funding is done through internal loans from the state's Pooled Money Investment Account.) The state then issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes (and internal loans). Pursuant to the terms of the bank credit agreement presently in effect, the general obligation commercial paper program may have up to $1.5 billion in aggregate principal and interest commitments at any time. The state is in the process of increasing the credit agreement to $2.5 billion. This amount may be increased or decreased in the future. As of May 1, 2007, $1,315,385,000 aggregate principal amount of general obligation commercial paper notes had been issued and were outstanding. See "STATE DEBT TABLES" below for more recent information concerning outstanding commercial paper notes. Commercial paper notes are not included in the calculation of permitted variable rate indebtedness described above under "General Obligation Bonds."

Lease-Purchase Obligations

In addition to general obligation bonds, the state builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another state or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a state agency or the University of California under a long-term lease that provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the state's lease obligation, which are then marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the State Constitutional provisions that require voter approval. For purposes of this Appendix A and the tables under "STATE DEBT TABLES," "lease-purchase obligation" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a state energy efficiency program secured by payments made by various state agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund. See "STATE FINANCES—Sources of Tax Revenue—Special Fund Revenues." The tables under "STATE DEBT TABLES" do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The state had $7,766,296,154 General Fund-supported lease-purchase obligations outstanding as of May 1, 2007. The State Public Works Board, which is authorized to sell lease revenue bonds, had $2,932,071,137 authorized and unissued as of May 1, 2007. In addition, as of that date, certain joint powers authorities were authorized to issue approximately $81,000,000 of revenue bonds to be secured by state leases.

On May 3, 2007, the Governor signed AB 900 (Chapter 7, Statutes of 2007) which authorized issuance of up to $7.4 billion of lease-revenue bonds to finance acquisition, design and construction of new facilities at state prisons and county jails and for local re-entry facilities. See "CURRENT STATE BUDGET – Strategic Growth Plan – Prison Construction Program" below.

Future Issuance Plans

In light of the significant new authorizations of general obligations bonds and lease revenue bonds in the past year, the State Treasurer's Office has indicated that it expects the volume of issuance of both of these categories of bonds to increase substantially, compared to previous years, starting in fiscal year 2007-08. While the exact schedule for issuance will depend on many factors, including the needs of state departments, market conditions and other matters, the State Treasurer's Office foresees issuance of as much as $12-16 billion per fiscal year by 2009-10, with amounts reducing thereafter, but this does not take into account any possible new bond authorizations in the future, or issuance of refunding bonds.

Non-Recourse Debt

Certain state agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from state revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. State agencies and authorities had $48,367,394,318 aggregate principal amount of revenue bonds and notes which are non–recourse to the General Fund outstanding as of December 31, 2006, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "STATE DEBT TABLES."

Detailed information regarding the state's long-term debt appears in the section "STATE DEBT TABLES."

Pension Obligation Bonds

Pursuant to the California Pension Restructuring Bond Act of 2004, Government Code Section 16940, et seq. (the “Restructuring Bond Act”), the state proposed to issue pension obligation bonds to make future contributions to the California Public Employees’ Retirement System (“CalPERS”). The payment of the debt service on the pension obligation bonds would be payable from the General Fund.

Pursuant to the Restructuring Bond Act, the Pension Obligation Bond Committee (the ”Committee”) authorized the issuance of bonds to pay a portion of the state’s pension obligation for fiscal year 2004-05 or a subsequent fiscal year. The Committee initiated a validation action seeking court determination that the bonds would not be in violation of the Constitutional debt limit because the proceeds of the bonds would be used to pay the state’s employer contribution obligation to CalPERS, which is an “obligation imposed by law.” The validation action was challenged in the court by the Pacific Legal Foundation, and this legal challenge prevented the issuance of any pension obligation bonds in time to pay the pension contribution during either fiscal year 2004-05 or fiscal year 2005-06. After a trial in the Sacramento County Superior Court, the judge ruled on November 15, 2005 that the bonds were not valid. The Committee has filed a notice of appeal. Briefing has been completed and the matter has been scheduled for oral argument on June 25, 2007. The Administration has not included pension obligation bonds in the revised plan for 2007-08 set out in the 2007-08 May Revision, but will assume sale of the bonds in 2008-09. See “LITIGATION – Matter Seeking Validation of Pension Obligation Bonds.”

Economic Recovery Bonds

The California Economic Recovery Bond Act (“Proposition 57”) was approved by the voters at the statewide primary election on March 2, 2004. Proposition 57 authorizes the issuance of up to $15 billion in economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. Repayment of the economic recovery bonds is secured by a pledge of revenues from a one-quarter cent increase in the state’s sales and use tax starting July 1, 2004. In addition, as voter-approved general obligation bonds, the economic recovery bonds are secured by the state’s full faith and credit. However, moneys in the General Fund will only be used in the event the dedicated sales and use tax revenue is insufficient to repay the bonds.

The state has issued $10.896 billion principal amount of economic recovery bonds, resulting in the deposit of net proceeds to the General Fund of approximately $11.254 billion during the 2003-04 fiscal year (of which, for budgetary purposes, approximately $9.242 billion was applied to the 2002-03 fiscal year and approximately $2.012 billion was applied to offset fiscal year 2004-05 General Fund expenditures). The state may issue the remainder of authorized economic recovery bonds at any time in the future, but the 2006 Budget Act assumes no economic recovery bonds will be issued in fiscal year 2006-07.

Three different sources of funds are required to be applied to the early retirement (generally by purchase or redemption) of economic recovery bonds: (i) all proceeds from the dedicated quarter cent sales tax in excess of the amounts needed, on a semi-annual basis, to pay debt service and other required costs of the bonds, (ii) all proceeds from the sale of surplus state property, and (iii) fifty percent of each annual deposit, up to $5 billion in the aggregate, of future deposits in a Budget Stabilization Account (“BSA”) created by the California Balanced Budget Act (see “THE BUDGET PROCESS – Constraints on the Budget Process –Proposition 58” below). Funds from sources (i) and (ii) above were used for early retirement of approximately $623 million of bonds during fiscal year 2005-06. Pursuant to the California Balanced Budget Act, the 2006 Budget Act included approximately $472 million which was transferred from the BSA, and which will also be used to retire economic recovery bonds in addition to the moneys identified in the previous sentence. Using these sources of moneys, the state redeemed $585 million of variable rate economic recovery bonds on March 1, 2007, and will redeem an additional $508.2 million on July 1, 2007.

The budget for 2007-08 will include $1.023 billion from the BSA to retire economic recovery bonds in the 2007-08 fiscal year. The 2007-08 May Revision proposes appropriation of an additional $600 million for this purpose but this has not yet been agreed to by the Legislature. It is also expected there will be excess sales taxes which will be used to retire economic recovery bonds in 2007-08.

Tobacco Settlement Revenue Bonds

In 1998 the state signed a settlement agreement (the "Master Settlement Agreement" or "MSA") with the four major cigarette manufacturers (the "participating manufacturers" or "PMs"). Under the MSA, the participating manufacturers agreed to make payments to the state in perpetuity, which payments amount to approximately $25 billion (subject to adjustments) over the first 25 years. Under a separate Memorandum of Understanding, half of the payments made by the cigarette manufacturers will be paid to the state and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The specific amount to be received by the state and local governments is subject to adjustment. Details in the MSA allow reduction of the manufacturers' payments for decreases in cigarette shipment volumes by the settling manufacturers, payments owed to certain "Previously Settled States" and certain types of offsets for disputed payments, among other things. However, settlement payments are adjusted upward each year by at least 3 percent for inflation, compounded annually.

Chapter 414, Statutes of 2002, enacted Government Code Sections 63049 to 63049.5 (the "Tobacco Securitization Law"), which authorized the establishment of a special purpose trust to purchase those assets. The bill also authorized that entity to issue revenue bonds secured by the tobacco settlement revenues received beginning in the 2003–04 fiscal year. An initial sale of 56.57 percent of the state's tobacco settlement revenues producing $2.485 billion in proceeds was completed in January 2003 ("Series 2003A").

A second sale of the remaining 43.43 percent of the state's tobacco settlement revenues, which produced $2.264 billion in proceeds, was completed in September 2003 ("Series 2003B"). Chapter 225, Statutes of 2003, amended the Tobacco Securitization Law to require the Governor to request an appropriation in the annual Budget Act to pay debt service and other related costs of the tobacco settlement revenue bonds secured by the second (and only the second) sale of tobacco settlement revenues when such tobacco settlement revenues are insufficient therefor. The Legislature is not obligated to make any such requested appropriation.

In August, 2005, the Series 2003B Bonds were refinanced ("Series 2005A"), retaining substantially all of the covenants of the original issue, including the covenant regarding the request for a General Fund appropriation in the event tobacco settlement revenues fall short. In return for providing this covenant, the state was paid a credit enhancement fee of $525 million as part of the refinancing. See "PRIOR FISCAL YEAR'S BUDGETS – 2005 Budget Act – Financial Instruments." On March 14, 2007, the state completed a refunding of all of the Series 2003A Bonds. This refunding generated additional proceeds of approximately $1.258 billion which are intended to be used (i) to offset the General Fund cost for the initial years of a litigation settlement related to the 2004-05 suspension of the Proposition 98 guarantee and (ii) for other purposes, such as funding capital projects. See "STATE FINANCES – Proposition 98."

In early 2006, the participating manufacturers asserted that they had lost market share in calendar year 2003 to the non-participating manufacturers ("NPMs"). A nationally recognized firm of economic consultants confirmed the assertion that the MSA was a significant factor contributing to the market share loss. As such, the participating manufacturers are authorized to withhold up to three times the amount of lost market share (adjusted downward by 2%) until such time as it is proven that the various states diligently enforced their model statutes that govern the NPMs. As a result, the amount of tobacco settlement revenues received by the state was reduced in 2006 by $50.9 million. Nevertheless, the amount of tobacco settlement revenues received were still in excess of the required debt service payments. Therefore, it is anticipated that the need to invoke the provisions included in the state's budget for Series 2005A is unlikely and there was and will be no impact to the General Fund for the 2006-07 or 2007-08 fiscal years. Furthermore, the Series 2005A Bonds have reserve funds in excess of one year's debt service payments, which would be used before General Fund moneys. In April 2006, a similar filing was made by the PMs for the calendar year 2004 payments and the economic consultants also confirmed that the MSA was a significant factor contributing to the market share loss, but it is anticipated that there is and will be no impact to the General Fund for the 2006-07 or 2007-08 fiscal years. The State Attorney General is working, in tandem with the other States Attorney General, under the terms of the MSA, to compel the PMs to pay given that the state has been diligently enforcing the statutes as required in the MSA.

Tobacco settlement revenue bonds are neither general nor legal obligations of the state or any of its political subdivisions and neither the faith and credit nor the taxing power nor any other assets or revenues of the state or of any political subdivision is or shall be pledged to the payment of any such bonds.

Cash Flow Borrowings

As part of its cash management program, the state has regularly issued short-term obligations to meet cash flow needs. The state has issued revenue anticipation notes ("Notes" or "RANs") in 19 of the last 20 fiscal years to partially fund timing differences between receipts and disbursements, as the majority of General Fund revenues are received in the last part of the fiscal year. By law, RANs must mature prior to the end of the fiscal year of issuance. If additional external cash flow borrowings are required, the state has issued revenue anticipation warrants ("RAWs"), which can mature in a subsequent fiscal year. See "STATE FINANCES—State Warrants." RANs and RAWs are both payable from any "Unapplied Money" in the General Fund of the state on their maturity date, subject to the prior application of such money in the General Fund to pay Priority Payments. "Priority Payments" are payments as and when due to: (i) support the public school system and public institutions of higher education (as provided in Section 8 of Article XVI of the Constitution of the State), (ii) pay principal of and interest on general obligation bonds and general obligation commercial paper notes of the state, (iii) provide reimbursement from the General Fund to any special fund or account to the extent such reimbursement is legally required to be made to repay borrowings therefrom pursuant to California Government Code Sections 16310 or 16418; and (iv) pay state employees' wages and benefits, state payments to pension and other state employee benefit trust funds, state Medi-Cal claims, and any amounts determined by a court of competent jurisdiction to be required to be paid with state warrants that can be cashed immediately. See "STATE FINANCES" below.

The following table shows the amount of RANs and RAWs issued in the past five fiscal years. The state issued $1.5 billion of RANs in October, 2006 in order to maintain adequate reserves to manage the state's cash flow requirements during fiscal year 2006-07. This was the smallest state RAN borrowing since 2000-01.

TABLE 1

State of California Revenue Anticipation Notes and Warrants Issued
Fiscal Years 2001-02 to 2006–07

Fiscal Year	Type	Principal Amount (Billions)	Date of Issue	Maturity Date
2001–02	Notes Series A-C	$5.70	October 4, 2001	June 28, 2002
	RAWs Series A	1.50	June 24, 2002	October 25, 2002
	RAWs Series B	3.00	June 24, 2002	November 27, 2002
	RAWs Series C	3.00	June 24, 2002	January 30, 2003†
2002–03	Notes Series A and C	6.00	October 16, 2002	June 20, 2003
	Notes Series B and D	3.00	October 16, 2002	June 27, 2003
	Notes Series E – G	3.50	November 6, 2002	June 20, 2003
	RAWs Series A and B	10.965	June 18, 2003	June 16, 2004
2003–04	Notes	3.00	October 28, 2003	June 23, 2004
2004–05	Notes Series A – D	6.00	October 6, 2004	June 30, 2005
2005-06	Notes	3.00	November 10, 2005	June 30, 2006
2006-07	Notes	1.50	October 3, 2006	June 29, 2007

† Called by the State Controller and paid on November 27, 2002.

Source: State of California, Office of the State Treasurer.

STATE FINANCES

The General Fund

The moneys of the state are segregated into the General Fund and over 900 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the state. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See "FINANCIAL STATEMENTS." The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor (including the annual Budget Act), as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the state from unforeseen revenue reductions and/or unanticipated expenditure increases. The State Controller may transfer amounts in the SFEU to the General Fund as necessary to meet cash needs of the General Fund and such transfers are characterized as "loans." The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the State Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the state's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit." In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes. Under Proposition 58, the state will also have a second budgetary reserve, called the Budget Stabilization Account. See "THE BUDGET PROCESS – Constraints on the Budget Process –Balanced Budget Amendment (Proposition 58)."

See Figure 2 under "CURRENT STATE BUDGET - 2006 Budget Act" and Table 17 for information concerning the recent balances in the SFEU and projections of the balances for the previous and current fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors, including re-estimates of revenues and expenditures, existing statutory requirements and additional legislation introduced and passed by the Legislature may impact the fiscal year-end balance in the SFEU.

Inter-Fund Borrowings

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," comprised of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to such special fund as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

As of April 30, 2007, there were $2.923 billion of loans from the SFEU and other internal sources to the General Fund. See EXHIBIT 1 – "STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006-APRIL 30, 2007 (UNAUDITED)."

Any determination of whether a proposed borrowing from one of the special funds is permissible must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The State Attorney General has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General

Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the state.

At the November 1998 election, voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual Budget Act. Since the General Fund may reborrow from the transportation accounts any time after the annual repayment is made, the proposition does not have any adverse impact on the state's cash flow.

In addition to temporary inter-fund borrowings described in this section, budgets enacted in the current and past fiscal years have included other transfers and long-term loans from special funds to the General Fund. In some cases, such loans and transfers have the effect of reducing internal borrowable resources.

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 2003-04 through 2005–06 and estimates, as of May 18, 2007, for fiscal years 2006-07 and 2007-08. See also EXHIBIT 1 – "STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006 – APRIL 30, 2007 (UNAUDITED)."

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

TABLE 2

Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30				
	2004[(a)]	2005	2006	2007[(b)]	2008[(b)]
Available Internal Borrowable Resources	$9,951.3	$10,005.3	$11,708.9	$15,476.0	$14,225.1
Outstanding Loans					
From Special Fund for Economic Uncertainties and Budget Stabilization Account	-0-	-0-	-0-	-0-	1,765.3
From Special Funds and Accounts	-0-	-0-	-0-	-0-	-0-
Total Outstanding Internal Loans	-0-	-0-	-0-	-0-	1,765.3.0
Unused Internal Borrowable Resources	$9,951.3	$10,005.3	$11,708.9	$15,476.0	$12,459.8

(a) Includes the receipt of $11.254 billion of economic recovery bond proceeds to the General Fund resulting from the issuance of three series of economic recovery bonds.

(b) Department of Finance estimates as of May 18, 2007.

Source: State of California, Department of Finance. Information for the fiscal years ended June 30, 2004 through June 30, 2006, are actual figures.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by state law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid subject to the prior application of such money to obligations of the state with a higher priority. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings." Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from state special funds (to the extent permitted by law). See "STATE FINANCES—The Special Fund for Economic Uncertainties" and "—Inter-Fund Borrowings."

Registered Warrants

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., suppliers and local governments) otherwise entitled to receive payments from the state. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of five percent per annum or at a higher rate if issued for an unpaid revenue anticipation note or in connection with some form of credit enhancement. Registered warrants may or may not have a fixed maturity date. Registered warrants that have no fixed maturity date, and registered warrants that bear a maturity date but, for lack of Unapplied Moneys, were not paid at maturity, are paid, together with all interest due, when the State Controller, with the approval of the PMIB, determines payment will be made. The State Controller then notifies the State Treasurer, who publishes a notice that the registered warrants in question are payable. The duties of the State Controller and the PMIB are ministerial in nature, and the State Controller and the PMIB may not legally refuse to pay the principal of or interest on any registered warrants on any date Unapplied Moneys are available in the General Fund after all priority payments have been made on that date.

Reimbursement Warrants

In lieu of issuing individual registered warrants to numerous creditors, state law provides an alternative procedure whereby the Governor, upon request of the State Controller, may authorize utilizing the General Cash Revolving Fund in the State Treasury to borrow from other state special funds to meet payments authorized by law. The State Controller may then issue "reimbursement warrants" in the financial market at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund exists solely to facilitate the issuance of reimbursement warrants. Reimbursement warrants may have a fixed maturity date.

The principal of and interest on reimbursement warrants must be paid by the State Treasurer on their respective maturity dates from any Unapplied Money in the General Fund and available for such payment. In the event that Unapplied Money is not available for payment on the respective maturity dates of reimbursement warrants, and refunding warrants (see "—Refunding Warrants") have not been sold at such times as necessary to pay such reimbursement warrants, such reimbursement warrants will be paid, together with all interest due thereon (including interest accrued at the original interest rate after the maturity date), at such times as the State Controller, with the approval of the PMIB, may determine.

The state has issued reimbursement warrants on several occasions in order to meet its cash needs when state revenues were reduced because of an economic recession, and the state incurred budget deficits. The state most recently issued reimbursement warrants in June 2002 and in June 2003.

Refunding Warrants

If there is not sufficient Unapplied Money in the General Fund to pay maturing reimbursement warrants, the State Controller is authorized under state law, with the written approval of the State Treasurer, to offer and sell a new issue of reimbursement warrants as refunding warrants to refund the prior, maturing reimbursement warrants. Proceeds of such refunding warrants must be used exclusively to repay the maturing warrants. In all other respects, refunding warrants have the same legal status and provisions as reimbursement warrants, as described above.

Sources of Tax Revenue

The following is a summary of the state's major tax revenues. Further information on state revenues is contained under "CURRENT STATE BUDGET" and "STATE FINANCES—Recent Tax Receipts." See Table 4 entitled "Comparative Yield of State Taxes—All Funds, 2002–03 Through 2007–08" for a comparison, by amount received, of the sources of the state's tax revenue.

Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior tax years. Penalties were waived for taxpayers who applied for amnesty during the amnesty period of February 1, 2005 to March 31, 2005. Although taxpayers had to apply within this time frame, taxpayers had until the end of May 2005 to submit their tax returns and pay amounts owed. At the conclusion of amnesty, taxpayers who could have applied for amnesty but did not are subject to higher penalties if found to owe additional amounts for amnesty years. The amnesty program is estimated to result in a net multi-year General Fund revenue gain of $380 million. See "PRIOR FISCAL YEARS' BUDGETS – Fiscal Years Prior to 2005-06 – Tax Amnesty Program" below.

The 2007-08 May Revision includes the following revenue proposals that were in the Governor's Budget:

- Repeal of the teacher tax credit, resulting in an estimated revenue gain of $170 million in 2007-08.

- Permanent collection of the use tax on vessels, vehicles, and aircraft brought into the state within one year of purchase. This is estimated to result in a revenue gain of $21 million in 2007-08.

- Additional efforts to reduce the "tax gap," which tax professionals define as the difference between what taxpayers should pay and what is actually paid, are estimated to result in $77.5 million in additional personal income tax and corporation tax revenues in 2007-08.

- Strengthened sales and use tax enforcement is estimated to result in $13.2 million of additional revenues in 2007-08.

- Increased collections workload for the alcoholic beverages tax is estimated to bring in an additional $1.3 million in 2007-08.

Personal Income Tax

The California personal income tax, which accounts for a significant portion of General Fund tax revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions), with rates ranging from 1.0 percent to 9.3 percent. The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax ("AMT"), which is much like the federal AMT. The personal income tax structure is considered to be highly progressive. For example, the Franchise Tax Board indicates that the top 1 percent of taxpayers paid 47.5 percent of the total personal income tax in tax year 2005.

Proposition 63, approved by the voters in the November 2004 election, imposes a 1 percent surtax on taxable income over $1 million in addition to the 9.3 percent rate. The surtax became effective January 1, 2005. The proceeds of the tax surcharge are required to be used to expand county mental health programs.

Taxes on capital gains realizations and stock options, which are largely linked to stock market performance, can add a significant dimension of volatility to personal income tax receipts. Capital gains and stock option tax receipts have accounted for as much as 24.7 percent and as little as 7.3 percent of General Fund revenues in the last ten years. The 2007-08 May Revision estimates that capital gains and stock option tax receipts will account for 15.3 percent of General Fund revenue and transfers in 2006-07 and 15.1 percent in 2007-08. See "CURRENT STATE BUDGET—Economic Assumptions."

Under California law, interest on municipal bonds issued by the state and by California local government agencies is exempt from state personal income tax, but interest from municipal bonds issued in other states (except to the extent provided by federal law) is subject to state personal income tax. On May 21, the United States Supreme Court agreed to hear the appeal of a case titled *Department of Revenue of the State of Kentucky v. Davis* (the "*Davis* case"). A state court in Kentucky had ruled that the Kentucky state income tax law, which like California exempts only interest on bonds from in-state government entities, violates the Commerce Clause of the U.S. Constitution, by discriminating against other states' municipal bonds. If the Supreme Court upholds the lower court decision in the *Davis* case, and if the state is required to exempt the interest on all other states' municipal bonds from state income tax, the state may face a refund liability for the tax collected in prior years from taxpayers who reported interest income from out-of-state bonds. The Franchise Tax Board has made preliminary estimates that such a change in tax rules would result in a first-year cost of about $90 million, rising to about $180 million in the second year, and then falling in subsequent years to a level of about $165-170 million; these figures reflect a combination of possible tax refunds and reduced tax revenues. A decision in the *Davis* case is not expected until late 2007 or early 2008, so any fiscal impacts are not likely to occur until after the 2007-08 fiscal year.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

As of January 1, 2007, the breakdown of the base state and local sales tax rate of 7.25 percent is as follows:

- 5 percent imposed as a state General Fund tax;
- 0.5 percent dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent dedicated to local governments for public safety services (Local Public Safety Fund);
- 1 percent local tax imposed under the Uniform Local Sales and Use Tax Law, with 0.25 percent dedicated to county transportation purposes and 0.75 percent for city and county general-purpose use; and
- 0.25 percent deposited into the Fiscal Recovery Fund to repay the state's economic recovery bonds (the "Special Sales Tax").

Existing law provides that 0.25 percent of the basic 5 percent state tax rate may be suspended in any calendar year upon certification by the Director of Finance by November 1 in any year in which both of the following occur: (1) the General Fund reserve (excluding the revenues derived from the 0.25 percent Special Sales Tax) is expected to exceed 3 percent of revenues in that fiscal year (excluding the revenues derived from the 0.25 percent Special Sales Tax) and (2) actual revenues for the period May 1 through September 30 equal or exceed the May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines conditions (1) or (2) above are not met for that fiscal year. The Department of Finance estimates that the reserve level will be insufficient to trigger a reduction for calendar year 2008. See "CURRENT STATE BUDGET—Summary of State Revenues and Expenditures" for a projection of the fiscal year 2007-08 General Fund reserve.

Existing law provides that the Special Sales Tax will be collected until the first day of the calendar quarter at least 90 days after the Director of Finance certifies that all economic recovery bonds and related obligations have been paid or retired or provision for their repayment has been made or enough sales taxes have been collected to pay all economic recovery bonds and related obligations to final maturity. At such time the Special Sales Tax will terminate and the city and county portion of taxes under the Uniform Local Sales and Use Tax will be automatically increased by 0.25 percent. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Economic Recovery Bonds" above.

Senate Constitutional Amendment No. 4, approved by the voters as Proposition 1A in the November 2004 election, amended the state Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by restricting the state from lowering the local sales tax rate or changing the allocation of local sales tax revenues without meeting certain conditions. See "STATE FINANCES—Local Governments."

Corporation Tax

Corporation tax revenues are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the state.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The alternative minimum tax ("AMT") is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to $800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

6. Fees paid by limited liability companies, which account for 3.3 percent of corporation tax revenue are considered "corporation taxes." The constitutionality of these fees is currently being challenged in three separate state courts. Potential refunds are estimated at up to $1.04 billion in 2007-08 and up to $260 million in 2008-09 on a cash basis. In addition, there would be annual losses of up to $340 million in 2008-09 and increasing amounts in future years. See "LITIGATION – Tax Refund Cases."

On February 23, 2004, the U.S. Supreme Court denied the Franchise Tax Board's appeal requesting review of the decision in *Farmer Brothers Company v. Franchise Tax Board*, a tax refund case which involved the deductibility of corporate dividends. Potential revenue losses are estimated to total

$400 million over several fiscal years through 2007–08 (some revenue gains are expected in fiscal years after that). The revenue impact from this case is included in state budget projections for fiscal years 2006-07 and 2007-08.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits.

The Board of Equalization recently ruled that the premium tax insurers pay should be calculated on a cash basis rather than the accrual method used by the Department of Insurance. This is expected to result in a total loss of $406 million spread over several years; the 2007-08 impact is estimated to be $175 million.

Estate Tax; Other Taxes

The California estate tax is based on the state death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Economic Growth and Tax Relief Reconciliation Act") phases out the federal estate tax by 2010. As a consequence, the Economic Growth and Tax Relief Reconciliation Act resulted in the reduction of the state estate tax revenues by 25 percent in calendar year 2002, 50 percent in calendar year 2003, and 75 percent in calendar year 2004, and the elimination of the state estate tax beginning in calendar year 2005. The provisions of this federal act sunset after 2010. At that time, the federal estate tax will be reinstated along with the state's estate tax, unless future federal legislation is enacted to make the provisions permanent. See Table 4 entitled "Comparative Yield of State Taxes—All Funds, 2002-03 Through 2007-08."

Other General Fund major taxes and licenses include: Inheritance and Gift Taxes; Cigarette Taxes; Alcoholic Beverage Taxes; Horse Racing License Fees and Trailer Coach License Fees.

Special Fund Revenues

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

- Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.

- Charges for special services to specific functions, including such items as business and professional license fees.

- Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 34 percent of all special fund revenues in fiscal year 2005-06. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 2005-06, $8.4 billion was derived from the ownership or operation of motor vehicles. About $3.4 billion of this revenue was returned to local governments. The remainder was available for various state programs related to transportation and services to vehicle owners. For a discussion of Proposition 1A, approved by the voters in November 2004, which replaced vehicle license fees with increased property tax revenues, see "STATE FINANCES—Local Governments—Vehicle License Fee."

Taxes on Tobacco Products

As a result of Proposition 99, approved by the voters in 1988, and Proposition 10, approved by the voters in 1998, the state imposes an excise tax on cigarettes of 87 cents per pack and the equivalent rates on other tobacco products. Tobacco product excise tax revenues are earmarked as follows:

1. Fifty cents of the per-pack tax on cigarettes and the equivalent rate levied on non–cigarette tobacco products are deposited in the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.

2. Twenty-five cents of the per-pack tax on cigarettes and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs.

3. Ten cents of the per-pack tax is allocated to the state's General Fund.

4. The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income for the past four years, the current fiscal year, and the budget year.

TABLE 3

Recent Tax Receipts

	Trend of State Taxes per Capita[(a)]		Taxes per $100 of Personal Income	
Fiscal Year	**General Fund**	**Total**	**General Fund**	**Total**
2002–03	$1,833.10	$2,133.14	$5.65	$6.58
2003–04	1,951.34	2,268.10	5.92	6.88
2004–05	2,192.76	2,566.46	6.31	7.39
2005–06[(b)]	2,447.02	2,863.35	6.77	7.93
2006–07[(c)]	2,495.50	2,932.73	6.59	7.75
2007–08[(c)]	2,582.09	3,041.95	6.55	7.72

(a) Data reflects population figures based on the 2000 Census.

(b) Preliminary.

(c) Estimated.

Source: State of California, Department of Finance.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

The following table displays the actual and estimated revenues by major source for the last four years, the current fiscal year, and the budget year. This table shows taxes that provide revenue both to the General Fund and state special funds.

TABLE 4

Comparative Yield of State Taxes — All Funds 2002–03 Through 2007–08 (Modified Accrual Basis) (Thousands of Dollars)

Year Ending June 30	Sales and Use[a]	Personal Income	Corporation	Tobacco	Inheritance, Estate and Gift[b]	Insurance	Alcoholic Beverages	Horse Racing	Motor Vehicle Fuel[c]	Motor Vehicle Fees[d]
2003	27,177,756[f]	32,713,830	6,803,583	1,055,505	647,372	1,879,784	290,564	40,509	3,202,512	3,965,410
2004	28,948,622[f]	36,398,983	7,019,216	1,081,588	397,848	2,114,980	312,826	42,143	3,324,883	4,415,126
2005	32,638,090[f] [g]	42,912,860	8,670,065	1,085,721	213,035	2,232,954	314,251	38,491	3,366,142	4,882,664
2006	34,954,632[f] [g]	51,224,276	10,316,466	1,088,214	3,786	2,202,328	318,276	38,018	3,393,381	5,082,899
2007[e]	33,005,449[h]	53,665,000[i]	10,717,000	1,089,715	0	2,166,000	320,800	38,259	3,486,023	5,253,735
2008[e]	34,598,097[h]	56,825,000[i]	11,053,000	1,101,135	0	2,181,000	324,500	38,259	3,545,851	5,532,090

(a) Numbers include local tax revenue from the 0.5 percent rate increase dedicated to local governments for the state-local health and welfare program realignment program. The 0.5 percent rate is equivalent to about $2.7 billion to $3.0 billion per year.

(b) The state estate tax is based on the state death tax credit allowed against the federal estate tax. As a result, the federal Economic Growth and Tax Relief Reconciliation Act progressively reduced the state estate tax in calendar years 2002 through 2004 and eliminates it beginning in calendar year 2005.

(c) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(d) Registration and weight fees, motor vehicle license fees and other fees. See "—Local Government – Vehicle License Fee" below.

(e) Estimated as of May 14, 2007.

(f) The figures do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Figures do include the 0.5 percent Local Public Safety Fund revenue.

(g) These figures include the temporary one-quarter cent tax increase which started to be collected in July, 2004, and which is deposited in the Fiscal Recovery Fund and used for repayment of the economic recovery bonds. See "STATE FINANCES--Sources of Tax Revenue—Sales Tax."

(h) Unlike the figures for fiscal years ending June 30, 2003 through June 30, 2006, these estimated figures do not include the 0.5 percent Local Public Safety Fund revenue. These estimated figures also do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Estimate for fiscal year 2006–07 includes $1.43 billion and for fiscal year 2007–08 includes $1.492 billion for the temporary one-quarter cent tax described in footnote (g).

(i) Includes the revenue estimate for a 1 percent surcharge on taxpayers with taxable income over $1 million, with the proceeds funding mental health programs pursuant to Proposition 63.

NOTE: This table shows taxes that provide revenue both to the General Fund and state special funds. Also, some revenue sources are dedicated to local governments. This accounts for differences between the information in this table and Table 18.

Source: Fiscal years 2002–03 through 2005–06: State of California, Office of the State Controller.
Fiscal years 2006–07 and 2007–08: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of state expenditures, including both General Fund and special fund programs.

TABLE 5

Governmental Cost Funds (Budgetary Basis) Schedule of Expenditures by Function and Character Fiscal Years 2001–02 to 2005–06 (Thousands)

	2001–02	2002–03	2003–04	2004–05	2005–06
Function					
Legislative, Judicial, Executive					
Legislative	$ 265,312	$ 276,462	$ 284,894	$ 408,426	$ 314,263
Judicial[(a)]	1,633,518	2,524,446	2,634,409	2,881,680	3,164,602
Executive	1,371,891	1,283,297	1,329,557	1,362,268	1,504,886
State and Consumer Services	1,100,942	955,054	946,584	1,025,817	1,174,171
Business, Transportation and Housing					
Business and Housing	240,237	184,573	235,742	196,209	199,665
Transportation	6,052,926	3,712,133	6,077,810	6,819,308	8,103,385
Technology, Trade and Commerce[(b)]	81,832	50,335	10,262	0	0
Resources	2,284,269	1,993,957	2,100,200	2,232,498	2,595,652
Environmental Protection	993,144	762,052	749,988	788,805	975,995
Health and Human Services	26,563,743	27,420,865	26,793,410	30,223,891	32,243,938
Correctional Programs	5,242,369	5,614,849	5,246,381	6,769,319	7,661,983
Education					
Education–K through 12	28,078,228	27,611,356	28,696,655	32,118,886	36,163,323
Higher Education	9,945,193	9,951,749	9,487,413	9,985,180	11,114,993
Labor and Workforce Development[(c)]	N/A	250,616	239,051	319,984	353,970
General Government					
General Administration	2,475,564	1,830,280	3,580,718	1,745,492	1,842,451
Debt Service	2,432,942	2,067,815	2,103,756	3,390,653	4,017,468
Tax Relief	3,028,703	4,446,940	3,782,731	665,597	666,691
Shared Revenues	5,528,996	2,784,970	2,664,766	1,691,964	3,003,378
Brown vs. U.S. Dept. of Health and Human Services	96,000	–	–	–	--
Other Statewide Expenditures	476,170	526,863	825,833	(1,128,219)	889,967
Expenditure Adjustment for Encumbrances[(d)]	(681,856)	2,365,728	363,473	(1,038,273)	(520,272)
Credits for Overhead Services by General Fund	(251,575)	(288,871)	(326,928)	(329,796)	(371,965)
Statewide Indirect Cost Recoveries	(47,862)	(50,313)	(59,081)	(74,581)	(83,338)
Total	$96,910,686	$96,275,156	$97,767,624	$100,055,108	$115,015,206
Character					
State Operations	$27,994,343	$26,241,065	$28,208,541	$28,783,825	$34,037,821
Local Assistance	67,993,721	69,043,191	68,086,507	70,217,159	78,626,805
Capital Outlay	922,622	990,900	1,472,576	1,054,124	2,350,580
Total	$96,910,686	$96,275,156	$97,767,624	$100,055,108	$115,015,206

(a) Included in this amount are the expenditures of the Trial Court Trust Fund. As of July 1, 2002, the Trial Court Trust Fund was reclassified to a Governmental Cost Fund from a Non-Governmental Cost Fund.

(b) As of January 2004, Technology, Trade and Commerce was abolished per Assembly Bill 1757 of 2003, Chapter 229. Funds that were abolished were transferred to the General Fund.

(c) Legislation was enacted effective January 1, 2003 which created a new agency function called the Labor and Workforce Development. Fiscal year 2002–03 figure reflects the expenditure for the entire fiscal year. The following agencies were transferred from General Government to this new function: the Employment Development Department, the California Workforce Investment Board, the Agricultural Labor Relations Board, and the Department of Industrial Relations.

(d) Expenditures for the State Highway Account (Fund 0042) and the Traffic Congestion Relief Fund (Fund 3007) are reported on a modified cash basis. This method of accounting eliminated all of the continuing appropriations in these two funds.

N/A – Not applicable

Source: State of California, Office of the State Controller.

State Appropriations Limit

The state is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the state from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the state, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Appropriations Limit for the prior year, adjusted annually for changes in state per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for fiscal years 2003-04 through 2007-08.

TABLE 6

State Appropriations Limit
(Millions)

	Fiscal Years				
	2003–04	**2004–05**	**2005–06**	**2006-07**	**2007-08**
State Appropriations Limit	$61,702	$64,588	$68,890	$72,304	$76,093[2]
Appropriations Subject to Limit	(47,921)	(53,488)	(61,386)[1]	(60,122)[1]	(64,258)[1]
Amount (Over)/Under Limit	$13,781	$11,100	$7,504[1]	$12,182[1]	$11,921[1]

[1] Estimated/projected as of January 10, 2007. Updated figures will not be available until adoption of the 2007 Budget Act.

[2] Estimated/projected as of May 12, 2007. Final figures will not be available until adoption of the 2007 Budget Act.

Source: State of California, Department of Finance.

Proposition 98

On November 8, 1988, the voters of the state approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed state funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 education a minimum level of funding. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 education the greater of: (a) in general, a fixed percentage of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 education in the prior year, adjusted for changes in state per capita personal income and enrollment ("Test 2"), or (c) a third test, which replaces Test 1 and Test 2 in any year that the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in state per capita personal income ("Test 3").

Legislation adopted prior to the end of the 1988-89 fiscal year implementing Proposition 98 determined the K-14 education's funding guarantee under Test 1 to be 40.7 percent of General Fund tax revenues, based on 1986-87 appropriations. However, this percentage has since been adjusted to approximately 41 percent of 1986-87 appropriations to account for subsequent changes in the allocation of local property taxes, since these changes altered the share of General Fund revenues received by schools. The Proposition 98 guarantee has typically been calculated under Test 2. Under Test 3, however, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5 percent. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a "credit" (called the "maintenance factor") to schools and is paid to them in future years when per capita General Fund revenue growth exceeds per capita personal income growth.

The Proposition 98 guarantee is funded from two sources: local property taxes and the General Fund. Any amount not funded by local property taxes is funded by the General Fund. Thus, local property tax collections represent an offset to General Fund costs in a Test 2 or Test 3 year.

Proposition 98 also contains provisions for the transfer of certain state tax revenues in excess of the Article XIII B limit to K-14 education in Test 1 years when additional moneys are available. No such transfers are anticipated during fiscal year 2007-08. See "STATE FINANCES—State Appropriations Limit."

The 2007-08 May Revision reflects General Fund Proposition 98 expenditures in fiscal years 2005-06 through 2007-08, as outlined in the table below. The 2007-08 May Revision includes a decrease of $294.9 million for declining growth (-0.48 percent) but provides full funding of $246.8 million for COLA (4.53 percent) adjustments in 2007-08, and also reflects the deferral of Proposition 98 expenditures of $1.303 billion from fiscal year 2005-06 to 2006-07, $1.303 billion from fiscal year 2006-07 to 2007-08, and $1.303 billion from fiscal year 2007-08 to 2008-09 for K-14 education.

The 2007-08 May Revision includes a technical error in which the cost of school district revenue limits was understated by approximately $364 million for 2007-08. However, resolution of this error will occur within the proposed Proposition 98 guarantee level for 2007-08 and consequently, will not affect the General Fund.

TABLE 7

Proposition 98 Funding
($ in Millions)

	2005-06		2006-07		2007-08	Change From Revised 2006-07	
	Enacted	**Revised**	**Enacted**	**Revised**	**Proposed**	**Amount**	**Percent**
K-12 Proposition 98							
State General Fund	$33,071	$35,005	$37,141	$37,052	$37,759	$707	1.9%
Local property tax revenue	11,573	11,677	11,973	12,346	13,584	1,238	10.0
Subtotals[(a)]	$44,644	$46,682	$49,114	$49,398	$51,343	$1,945	3.9%
Other Proposition 98							
State General Fund	$ 3,520	$ 3,670	$ 4,154	$ 4,140	$ 4,171	$ 31	0.7%
Local property tax revenue	1,804	1,931	1,853	1,857	2,052	195	10.5
Subtotals[(a)]	$5,324	$5,601	$6,007	$5,997	$6,223	$ 226	3.8%
Total Proposition 98							
State General Fund	$36,591	$38,675	$41,295	$41,192	$41,930	$738	1.8%
Local property tax revenue	13,377	13,608	13,826	14,203	15,636	1,433	10.1
Totals[(a)]	$49,968	$52,283	$55,121	$55,395	$57,566	$2,171	3.9%

(a) Totals may not add due to rounding.

Source: State of California, Department of Finance

Proposition 98 permits the Legislature, by a two-thirds vote of both houses (on a bill separate from the Budget Act), and with the Governor's concurrence, to suspend the K-14 education's minimum funding guarantee for a one-year period. The amount of the suspension is added to the maintenance factor, the repayment of which occurs according to a specified State Constitutional formula, and eventually restores Proposition 98 funding to the level that would have been required in the absence of such a suspension. Therefore, suspending the minimum funding guarantee provides ongoing General Fund savings over multiple fiscal years until the maintenance factor is fully repaid.

Legislation related to the 2004 Budget Act suspended the Proposition 98 minimum guarantee. At the time the 2004 Budget Act was enacted, this suspension was estimated to be $2.004 billion. This suspended amount was added to the existing maintenance factor, which was fully paid in 2005-06. However, subsequent growth in General Fund revenue increased the estimated 2004-05 Proposition 98 guarantee calculation by an additional $1.6 billion. This additional funding, along with approximately $1.1 billion in 2005-06 were the subject of a lawsuit, brought by the California Teachers Association ("CTA"), which has recently been settled. The terms agreed upon consist of retiring this approximately

$2.8 billion obligation beginning in 2007-08 with a $300 million payment and then in annual payments of $450 million beginning in 2008-09 until the full amount is paid.

The settlement of the CTA lawsuit was ratified by legislation enacted in September, 2006 (Chapter 751, Statutes of 2006). In addition, legislation was approved to refinance the Golden State Tobacco Securitization Corporation's Series 2003A Bonds, which became effective on January 1, 2007. Of the $1.258 billion in additional funds raised from the refinancing, which was completed on March 14, 2007, the first $900 million will offset initial costs of the settlement.

For 2006-07 and 2007-08, Test 3 is used to determine the Proposition 98 guarantee. As a result, after proposed payments in 2006-07 and 2007-08, the total estimated maintenance factor balance will be $65.5 million at the end of fiscal year 2007-08. This maintenance factor balance is required to be restored to the Proposition 98 budget over future years as explained above.

Proposition 98 appropriations for fiscal years 1995-96, 1996-97, 2002-03, and 2003-04 are cumulatively estimated to be $1.4 billion below the amounts required by Proposition 98 for those years because of changes in various Proposition 98 factors applicable to those years. Chapter 216, Statutes of 2004, annually appropriates $150 million per year beginning in fiscal year 2006-07, to repay these prior year Proposition 98 obligations. However, Chapter 491, Statutes of 2005, appropriated $16.8 million toward these settle-up obligations during the 2005-06 fiscal year, and explicitly reduced the first Chapter 216 settle-up appropriation, from $150 million to $133.2 million for 2006-07. The 2006 Budget Act included this appropriation along with a $150 million prepayment of the 2007-08 allocation.

In March, 2007 a series of reports, which had been requested by the California P-16 Council (an advisory committee to the Superintendent of Public Education) and the Governor's Committee on Education Excellence, were released on the financing and governance of K-12 public education in California and the quality of teachers and administrators. The reports included recommendations for changes in education governance, including reforms and an expectation that schools use resources more effectively, prior to adding the suggested additional funding levels. The Governor's Committee on Education Excellence will be reviewing these findings in more detail over the coming months and developing a set of policy recommendations for consideration by the Governor. The Governor has stated that he believes reform is needed to make better use of existing resources. There has been no commitment to provide any additional funding beyond that which is required by the Constitution.

Local Governments

The primary units of local government in California are the 58 counties, which range in population from 1,200 in Alpine County to approximately 10 million in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails, and public safety in unincorporated areas. There are also 478 incorporated cities in California and thousands of special districts formed for education, utilities, and other services. The fiscal condition of local governments has been constrained since Proposition 13, which added Article XIII A to the State Constitution, was approved by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Proposition 218, another constitutional amendment enacted by initiative in 1996, further limited the ability of local governments to raise taxes, fees, and other exactions. Counties, in particular, have had fewer options to raise revenues than many other local government entities, while they have been required to maintain many services.

In the aftermath of Proposition 13, the state provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including assuming principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature reduced the post-Proposition 13 aid to local government entities other than K-12 schools and community colleges by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources, such as sales taxes, and reduced certain mandates for local services funded by cities and counties. See "STATE FINANCES—Sources of Tax Revenue—Sales Tax" for a discussion of the impact of the economic recovery bond issuances on local sales taxes.

The 2004 Budget Act, related legislation and the enactment of Proposition 1A in 2004 (described below) dramatically changed the state-local fiscal relationship. These constitutional and statutory changes implemented an agreement negotiated between the Governor and local government officials (the "state–local agreement") in connection with the 2004 Budget Act. One change relates to the reduction of the vehicle license fee ("VLF") rate from 2 percent to 0.65 percent of the market value of the vehicle. In order to protect local governments, which have previously received all VLF revenues, the reduction in VLF revenue to cities and counties from this rate change was backfilled by an increase in the amount of property tax they receive.

As part of the state-local agreement, Proposition 1A ("Proposition 1A") was approved by the voters at the November 2004 election. Proposition 1A amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the state's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the state will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship, two–thirds of both houses of the Legislature approves the borrowing and the amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than two fiscal years within a period of 10 fiscal years, and only if previous borrowings have been repaid. In addition, the state cannot reduce the local sales tax rate or restrict the authority of the local governments to impose or change the distribution of the statewide local sales tax. Proposition 1A also prohibits the state from mandating activities on cities, counties, or special districts without providing the funding needed to comply with the mandates. Beginning in fiscal year 2005-06, if the state does not provide funding for the activity that has been determined to be mandated, the requirement on cities, counties, or special districts to abide by the mandate is suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate to encompass state action that transfers to cities, counties, and special districts financial responsibility for a required program for which the state previously had partial or complete responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights. See "THE BUDGET PROCESS—Constraints on the Budget Process—Local Government Finance (Proposition 1A of 2004)."

Vehicle License Fee

Prior to enactment of the 2004 Budget Act, vehicle license fees were assessed in the amount of two percent of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. A program to offset (or reduce) a portion of the VLF paid by vehicle owners was established by Chapter 322, Statutes of 1998. Beginning January 1, 1999, a permanent offset of 25 percent of the VLF paid by vehicle owners became operative. In 2000, a one-time offset of 35 percent took effect, resulting in a 1.3 percent rate paid by vehicle owners. In 2001, the offset was increased to 67.5 percent of two percent, resulting in an effective rate of 0.65 percent. This level of offset provided tax relief of $4.3 billion in fiscal year 2003–04.

In connection with the offset of the VLF, the Legislature authorized appropriations from the state General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged. In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient General Fund moneys would be available for this purpose, and, beginning in October 2003, VLF paid by vehicle owners were restored to the 1998 level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and offset payments to local governments resumed. Local governments received "backfill" payments totaling $3.80 billion in fiscal year 2002–03 and $3.1 billion in fiscal year 2003–04. In addition, the state-local agreement also provided for the repayment by August 2006 of the approximately $1.2 billion that was not received by local governments from July to October of 2003, which is the time period between the suspension of the offsets and the implementation of higher fees.

Beginning in fiscal year 2004–05, the state-local agreement permanently reduced the VLF rate to 0.65 percent, and eliminated the General Fund offset program. The State Constitution, amended by the voter approval of Proposition 1A in the November 2004 election, codifies the obligation of the state to provide replacement revenues to local governments for revenues lost as a result of the decrease in VLF rate below the current level of 0.65 percent of the market value of the vehicle.

The 2005 Budget Act provided for the early repayment, in fiscal year 2005-06, of the whole $1.2 billion in VLF backfill payments owed to local governments. This payment took place in August 2005. See "PRIOR FISCAL YEARS' BUDGETS – 2005 Budget Act."

Trial Courts

Prior to legislation enacted in 1997, local governments provided the majority of funding for the state's trial court system. The legislation consolidated the trial court funding at the state level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. The state's trial court system will receive approximately $2.6 billion in state resources in fiscal years 2006–07 and 2007–08 and $499 million in resources from the counties in each fiscal year.

Welfare System

The entire statewide welfare system was changed in response to the change in federal welfare law enacted in 1996 (see "Welfare System"). Under the CalWORKs (defined below) program, counties are given flexibility to develop their own plans, consistent with state law, to implement the program and to administer many of its elements. Counties are still required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

Welfare System

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193, the "Law") fundamentally reformed the nation's welfare system. The Law included provisions to: (i) convert Aid to Families with Dependent Children ("AFDC"), an entitlement program, to Temporary Assistance for Needy Families ("TANF"), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The TANF block grant formula under the Law is operative through September 30, 2010, as further described below.

Chapter 270, Statutes of 1997, embodies California's response to the federal welfare systems. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids ("CalWORKs") replaced the former AFDC and Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Caseload under CalWORKs is projected to decrease by 12.3 percent in 2007-08 from the 2006-07 projection. The revised CalWORKs caseload projections included in the 2007-08 May Revision are 461,200 cases in fiscal year 2006-07 and 404,300 cases in 2007-08. This sharp decline reflects the proposed policy changes described below and represents a major decline in caseload from the rapid growth of the early 1990s, when caseload peaked at 921,000 cases in fiscal year 1994–95. Since CalWORKs' inception in January 1998, caseload has declined by over 35 percent.

The federal Deficit Reduction Act of 2005 included legislation that reauthorized and extended the TANF program until September 30, 2010. The reauthorization legislation modifies countable work activities under TANF and applies new federal work participation rates to separate state programs. In addition, because reauthorization legislation effectively eliminates the state's caseload reduction credit, the bulk of the CalWORKs caseload will be subject to the 50 percent work participation level beginning in federal fiscal year 2007. Considerable improvement in work participation rates must be achieved to avoid federal penalties, which could cost the state and counties more than $1.5 billion over a five-year period. While these penalties likely would not be assessed until 2009-10, the 2007-08 May Revision proposes major programmatic changes that place greater emphasis on work participation and reduce reliance upon public assistance to significantly improve the ability of the state and counties to meet federal work requirements in the TANF program. Key components of this effort include:

- Implement Full Family Sanctions - This proposal strengthens work requirements and recipient accountability by imposing full sanctions for families when the adult continues to not comply with program requirements beyond 90 days. A full family sanction policy will reduce prolonged noncompliance while providing a reasonable timeframe to achieve compliance during which benefits are still available. This component is expected to increase California's work participation rate by almost 6 percent.

- Modify the Safety Net Program - The current safety net program minimizes the incentive for families to become self-sufficient. This proposal would reward working families by continuing safety net benefits for families beyond their 60-month time limit only if they meet federal work participation requirements. This component is expected to increase the state's work participation rate by over 5 percent.

- Consistent Child-Only Benefits – The 2007-08 Governor's Budget proposes to provide cash aid for families receiving child-only benefits that are consistent with other CalWORKs families. As such, aid to families receiving child-only benefits will be limited to 60 months. These families include parents or caretakers who are undocumented non-citizens, drug felons, or fleeing felons.

Although California's policy to date has been to limit total CalWORKs spending to only the available federal TANF Block Grant and combined state and county maintenance of effort ("MOE") funds, the 2007-08 May Revision identifies MOE expenditures in excess of the required level. By identifying expenditures of $492.5 million in 2006-07 and $161.5 million in 2007-08 to be counted toward the MOE in excess of the required level, California's caseload reduction credit will increase by an estimated 13 percent in federal fiscal year (FFY) 2008 and 4 percent in FFY 2009.

The 2007-08 May Revision includes total CalWORKs-related expenditures of $7 billion for 2006-07 and 2007-08. Both years include augmentations of $191.9 million for employment services to enable recipients to move off of aid and into sustainable employment, $90 million for counties to implement program improvements that lead to better outcomes and increased work participation rates for CalWORKs recipients, and $140 million to support county administration. The May Revision also continues to make available $40 million in Pay for Performance incentive funds for those counties that achieve improved program outcomes during 2006-07. The May Revision includes a TANF reserve of $140.3 million in 2007-08, which is available for unanticipated needs in any program for which TANF Block Grant funds are appropriated, including CalWORKs benefits, employment services, county administration, and child care costs.

In addition, the 2007-08 May Revision includes one-time costs of $17.2 million to support the automation changes necessary to move from quarterly recipient reporting requirements to a semi-annual reporting system during 2008-09. The proposed semi-annual reporting system for CalWORKs and food stamp recipients is expected to simplify the recipient reporting process and generate savings compared to the current quarterly reporting requirements.

Other 2007-08 CalWORKs savings proposals from the Governor's Budget continue to be reflected in the 2007-08 May Revision, including suspending the 2007-08 cost-of-living adjustment and utilizing available Proposition 98 resources in lieu of federal TANF funds to fully fund Stage 2 child care. These and several other proposals are projected to generate over $440 million General Fund savings in 2007-08.

Health Programs

Medi-Cal – Medi-Cal, California's Medicaid program, is a health care entitlement program for low-income individuals and families who receive public assistance or otherwise lack health care coverage. Medi-Cal serves just over one in six Californians. Federal law requires Medi-Cal to provide a set of basic services such as doctor visits, laboratory tests, x-rays, hospital inpatient and outpatient care, hospice, skilled nursing care, and early periodic screening, diagnosis and treatment. Also, federal matching funds are available if states choose to provide any of numerous optional benefits. The federal government pays for half of the cost of providing most Medi-Cal services in California, including optional benefits. A wide range of public and private providers and facilities delivers these services. Providers are reimbursed by the traditional fee-for-service method or by capitated payments from managed care plans. Approximately 3.3 million Medi-Cal beneficiaries (almost half of the people receiving Medi-Cal benefits and services) are currently enrolled in managed care plans. To help control program costs the state continues to transition fee-for-service counties to managed care.

Medi-Cal expenditures are estimated to be $35.4 billion ($13.6 billion from the General Fund), in 2006-07 and $37.7 billion ($14.7 billion General Fund) in 2007-08. The $2.3 billion ($1.1 billion General Fund) increase in 2007-08 is due primarily to increases in caseload, utilization, and costs for services.

Average monthly caseload in Medi-Cal was estimated to be 6.5 million in 2006-07. Caseload is expected to increase in 2007-08 by approximately 68,300, or 1.0 percent, to 6.6 million eligible people, as compared to an expected 1.2 percent increase in the state's population over the same period.

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005, which makes several changes to the federal Medicaid program that will impact Medi-Cal. The most significant fiscal change will require, beginning October 2009, states' managed care quality improvement fees to be assessed on all managed care plans, not just on those serving Medicaid beneficiaries. Without conforming statutory changes, the state would lose approximately $250 million in annual federal revenues beginning in 2009-10 due to non-compliance because current California law permits the state to only collect managed care quality improvement fees on managed care plans serving Medi-Cal beneficiaries.

In addition, the federal Deficit Reduction Act of 2005 requires, as a condition of receiving federal funds, that the Medi-Cal program verify the citizenship of those individuals who declare that they are citizens of the United States. Under this new provision, these individuals are required to show proof of identity and citizenship at the time of application and upon redetermination. This provision does not apply to or otherwise affect people who are applying for Medi-Cal as immigrants. California's statutory language now implements this change. State-level regulatory guidance is being developed as more specific implementation information becomes available from the federal government. The 2007-08 May Revision includes $50.4 million ($25.2 million General Fund) in costs for county level implementation activities.

The 2007-08 May Revision includes $214.3 million ($107.1 million General Fund) to provide rate adjustments for Medi-Cal managed care plans. The rate changes are based on recommendations made by an independent consultant to improve the Department of Health Care Services' rate-setting methodology and ensure continued federal financial participation for the Medi-Cal managed care program.

SSI/SSP – The federal Supplemental Security Income ("SSI") program provides a monthly cash benefit to eligible seniors and persons with disabilities who meet the program's income and resource requirements. In California, the SSI payment is augmented with a State Supplementary Payment ("SSP") grant. The 2007-08 May Revision includes $3.6 billion from the General Fund for the SSI/SSP Program in 2007-08. This represents a 2.8 percent increase from the revised 2006-07 funding level. The average monthly caseload in this program is estimated to be 1.3 million recipients in 2007-08, a 1.8 percent increase over the 2006-07 projected level.

The 2007-08 May Revision suspends the January 2008 state SSI/SSP cost-of-living adjustment, for a General Fund savings of $184.7 million in 2007-08 and more than $369 million annually thereafter. Effective January 1, 2008, the federal SSI payment will increase by an estimated 1.20 percent and the state SSP payment will remain unchanged.

Pension Trusts

The three principal retirement systems in which the state participates are the California Public Employees' Retirement System ("CalPERS"), the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"). The assets and liabilities of the funds administered by these systems, as well as certain other retirement funds administered by the state, are included in the financial statements of the state as fiduciary funds and described in Note 23 to the Audited Basic Financial Statements of the State of California for the Year ended June 30, 2006 (the "Audited Financial Statements"), incorporated by reference in this APPENDIX A. See "FINANCIAL STATEMENTS."

CalPERS

CalPERS administers the Public Employment Retirement Fund ("PERF"), which is a multiple employer defined benefit plan. In addition to the state, employer participants, as of June 30, 2006, included 1,053 school districts and 1,544 other public agencies. As of the same date, PERF had

1,048,895 active and inactive program members and 441,277 benefit recipients. The payroll for state employees covered by PERF for fiscal year 2004-05 was approximately $12.9 billion.

Employees, except those participating in the non-contributory, second tier plan (and who receive generally lower benefits) contribute to PERF based upon required contribution rates. Approximately 6.5 percent of the employees participate in the second tier plan. As part of a memorandum of understanding with the employee unions, the state agreed to suspend employee contributions for miscellaneous and industrial employees for fiscal years 2002-03 and 2003-04. The impact on the unfunded liability from suspending the employee contribution for two years was $354.5 million. These contributions will be repaid over the next thirty years through contributions toward the unfunded liability.

Contributions to PERF are determined annually on an actuarial basis. Payments into PERF are made from the employer contributions, including the state, and employee contributions. State contributions are made from the General Fund, Special Funds, and Non-Governmental Cost Funds. The following table shows the state's contributions to PERF for fiscal years 2002-03 through 2005-06 and its estimated contributions for fiscal year 2006-07 and 2007-08. Approximately 55 percent of the state contributions to PERF are made from the General Fund.

TABLE 8

State Contribution To PERF
Fiscal Years 2002-03 to 2007–08

Fiscal Year	Amount
2002–03	$1,190,000,000
2003–04	2,213,000,000
2004–05	2,564,000,000
2005–06	2,429,000,000
2006–07[1]	2,665,000,000
2007-08[1]	2,746,929,000

[1] Estimated.

Source: State of California, Department of Finance.

Increasing contributions shown in Table 8 (and which have been occurring since 2000-01) are due to several factors, including poor investment returns in the early 2000's and benefit enhancements enacted in 1999. See Table 9 below. The relative leveling off of contributions in 2005-06 and later years is due in part to new policies adopted by the CalPERS Board, described below.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Set forth below is a summary of additions and deductions from PERF for the five fiscal years shown. These figures reflect activity for all employers, including the state.

TABLE 9

Public Employees' Retirement Fund
Schedule of Additions and Deductions
($ in millions)*

	Fiscal Year Ended June 30,				
	2001	**2002**	**2003**	**2004**	**2005**
Contributions: Employer	$ 322	$ 801	$ 1,925	$ 4,262	5,774
Contributions: Employee	1,766	2,155	1,888	2,266	3,177
Total Contributions	$ 2,088	$ 2,956	$ 3,813	$ 6,528	8,951
Net Investment Income/(Losses) (including Appreciation)	(12,256)	(9,704)	5,474	24,266	21,894
Total Additions	(10,160)	(6,744)	9,296	30,801	30,845
Total Deduction (Benefits Paid and Administrative Expenses)	(6,106)	(6,743)	(7,320)	(7,980)	(8,798)
Net Assets as of the Beginning of the Fiscal Year	172,541	156,274	142,787	144,763	167,584
Net Assets as of the End of the Fiscal Year	156,274	142,787	144,763	167,584	189,631
Change in Net Assets	(16,266)	(13,487)	1,975	22,821	22,047

* Totals may not add up due to adjustments.

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Each employer (including the state) contributes an amount equal to the sum of the normal cost and amortization of the unfunded actuarial accrued liability, if any. Actuarial valuations of the PERF are performed as of June 30 of each year. The most recent valuation, as of June 30, 2005, showed an actuarial accrued unfunded liability allocable to state employees of $14.8 billion. The actuarial valuation for PERF was based upon an assumed 7.75 percent investment return. The average net rate of return experienced by PERF over the past fifteen years, ten years, and five years (in each case through fiscal year 2004-05) has been 9.6 percent, 9.3 percent, and 3.9 percent, respectively.

On April 19, 2005, the Board of Directors of CalPERS adopted a new policy for calculating the actuarial value of assets, spreading market value asset gains and losses over 15 years (rather than 3 years, as had been the practice) and changing the corridor limits for the actuarial value of assets from 90 percent–110 percent of market value to 80 percent–120 percent of market value. In addition, CalPERS will calculate the annual contribution amount with regard to gains and losses as a rolling 30 year amortization of all remaining unamortized gains or losses as opposed to the current 10 percent of such gains and losses. These changes are anticipated to reduce employer rate volatility by 50 percent.

Set forth below is a schedule of funding projections of the PERF with respect to the state's covered payroll. Actuarial information for each year is based upon an actuarial valuation performed as of the end of such fiscal year.

TABLE 10

Public Employees' Retirement Fund
Schedule of Funding Projections (State only)
($ in millions)

	Fiscal Year Ended June 30,				
	2001	**2002**	**2003**	**2004**	**2005**
Actuarial Value of Assets	$66,976	$62,201	$62,515	$67,081	$71,830
Actuarial Accrued Liabilities (AAL)-entry age	64,567	68,854	74,450	79,800	86,595
Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL)	2,409	(6,653)	(11,935)	(12,719)	(14,765)
Covered Payroll	11,905	12,423	12,628	12,624	13,790
Funded Ratio	103.7%	90.3%	84.0%	84.1%	82.9%

Source: CalPERS State and Schools Actuarial Valuation, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

CalSTRS

CalSTRS administers the Teacher's Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan ("STRP"). STRP is a cost-sharing, multi-employer, defined benefit pension plan that provides retirement, disability and survivor benefits for teachers and certain other employees of the California public school system. The STRP is comprised of three programs: the Defined Benefit Program ("DB Program"), the Defined Benefit Supplement Program ("DBS"), and the Cash Balance Benefit Program. Within the DB Program there is also a Supplemental Benefits Maintenance Account ("SBMA") which provides purchasing power protection for retired members. As of June 30, 2005, the DB Program had approximately 1,200 contributing employers, approximately 574,676 active and inactive program members and 201,241 benefit recipients.

The state's General Fund contributions to the DB Program and the SBMA are established by statute. The contribution rate to the DB Program is currently 2.017 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. This percentage resulted in a $472 million contribution for fiscal year 2004-05. The contribution rate to the SBMA is currently 2.5 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. This percentage resulted in a $585 million contribution for fiscal year 2004-05. In 2004, CalSTRS actuaries determined that there was an unfunded liability associated with the 1990 benefit structure and, as a result, the state was required to pay an additional 0.524 percent ($92 million from the General Fund) in fiscal year 2004-05 and one quarterly payment of $31 million in fiscal year 2005-06 to the DB Program. The 2004 valuation of CalSTRS found the 1990 benefit structure to be fully funded and the state was not required to make this additional contribution in fiscal year 2005–06. In early 2006, an error in the calculation of teacher's salaries was discovered in CalSTRS' accounting system. As a result, it was determined that the unfunded liability associated with the 1990 benefit structure never existed. After discovering the accounting error, CalSTRS also determined that the state had overpaid the DB Program and the SBMA in fiscal year 2002-03 and underpaid these accounts in fiscal years 2003-04 through 2005-06, resulting in a net underpayment of $3.1 million. Overall, the accounting error resulted in the state making excess contributions to CalSTRS in the amount of $119.5 million. For the 2006 Budget Act, this amount is to be recognized as a prepayment of the amounts owing from the state to the Teachers' Retirement Fund in 2006-07, which will correspondingly reduce the remaining amount to be transferred in 2006-07 from the

General Fund. Finally, an actuarial analysis performed in 2005 at the direction of the Department of Finance concluded that the currently required state contributions to the SBMA are more than sufficient to maintain purchasing power at 80 percent. The 2007-08 Governor's Budget is proposing to reduce the state's contributions to the SBMA from 2.5 percent to 2.2 percent of salary. In order to reduce the state's contributions, a corresponding benefit must be provided to teachers. Currently, the 80 percent level of supplemental payments is not a vested benefit. This means that if funding is not sufficient to bring purchasing power up to the 80 percent level, supplemental payments may have to be paid at a lower level. Vesting the benefit at 80 percent purchasing power protection would provide the corresponding benefit to teachers necessary to reduce the state's General Fund contribution.

The following table shows the state's contributions to CalSTRS for fiscal years 2002-03 through 2005-06 and its estimated contributions for fiscal years 2006-07 and 2007-08.

TABLE 11

State Contribution To CalSTRS
Fiscal Years 2002-03 to 2007–08

	DB Program	SBMA
2002–03	$430,538,000	$544,984,000
2003–04	450,895,000	58,868,000
2004–05	563,867,000	584,925,000
2005–06	499,697,000	581,367,000
2006–07(1)	360,182,000	598,391,000
2007-08(1)	501,416,000	546,909,000

(1) Estimated.

Source: State of California, Department of Finance.

The table above does not reflect the impact of the Superior Court decision requiring the state to pay $500 million of the contribution deferred in fiscal year 2003-04, to CalSTRS. See "LITIGATION—Challenge Seeking Payment to Teachers' Retirement Board."

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Set forth below is a summary of additions and deductions from the DB Program for the five fiscal years shown. These figures reflect activity for all employers, as well as the state's contribution.

TABLE 12

State Teachers' Retirement Defined Benefit Program Fund
Schedule of Additions and Deductions
($ in millions)*

	Fiscal Year Ended June 30,				
	2001	**2002**	**2003**	**2004**	**2005**
Contributions: Employer	$ 1,884	$ 1,725	$ 1,968	$ 2,047	$ 2,105
Contributions: Employee	1,843	1,873	2,094	2,210	2,327
Contributions: State[(1)]	946	916	1,015	549	1,219
Total Contributions	$ 4,674	$ 4,514	$ 5,077	$ 4,806	$ 5,650
Net Investment Income/(Losses) (including Appreciation)	(10,232)	(6,297)	3,688	16,607	14,138
Total Additions	(5,558)	(1,789)	8,765	21,412	19,779
Total Deduction (Benefits Paid and Administrative Expenses)	(4,086)	(4,639)	(5,102)	(5,723)	(6,317)
Net Assets as of the Beginning of the Fiscal Year	112,782	103,138	96,709	100,372	116,061
Net Assets as of the End of the Fiscal Year	103,138	96,709	100,372	116,061	129,524
Change in Net Assets	(9,644)	(6,428)	3,663	15,689	13,462

* Totals may not add up due to adjustments.
(1) Includes federal funds.

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005. California State Teachers Retirement System, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Each employer contributes 8.25 percent of payroll, while employees contribute 6 percent of pay. The most recent actuarial valuation, performed as of June 30, 2005 showed an actuarial accrued unfunded liability of $20.3 billion. The significant reduction in the unfunded liability of almost $3 billion since last year was largely due to the discovery of the error in CalSTRS' accounting system. The actuarial valuation of the DB Program is based upon an assumed 8 percent investment return. The average net rate of return experienced by the DB Program over the past fifteen years, ten years and five years (in each case through fiscal year 2005-06) was 10.4 percent, 9.5 percent, and 7.9 percent, respectively.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Set forth below is a schedule for funding projections for the DB Program for the five fiscal years shown. Actuarial information is based upon actuarial valuations performed as of the end of such fiscal year, except information as of June 30, 2002 is based upon actuarial valuation for June 30, 2001.

TABLE 13

State Teachers' Retirement Defined Benefit Program Fund
Schedule of Funding Projections
($ in millions)

	Fiscal Year Ended June 30,				
	2001	**2002[(1)]**	**2003**	**2004**	**2005**
Actuarial Value of Assets	$107,654	$107,654	$108,667	$114,094	$121,882
Actuarial Accrued Liabilities (AAL)-entry age	109,881	109,881	131,777	138,254	142,193
Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL)	(2,227)	(2,227)	(23,110)	(24,160)	(20,311)
Covered Payroll	20,585	20,585	23,867	23,764	23,293
Funded Ratio	98.0%	98.0%	82.5%	82.5%	85.7%

(1) Based upon actuarial valuation as of June 30, 2001.

Source: CalSTRS Defined Benefit Program Actuarial Valuation as of June 30, 2001, 2002, 2003, 2004, and 2005.

UC Regents

The University of California Retirement System consists of: (i) a retirement plan, which is a single employer defined benefit plan funded with university and employee contributions ("UCRP"); (ii) a voluntary early retirement incentive program, which is a defined benefit plan for employees who take early retirement ("PERS-VERIP"); and (iii) three defined contribution plans. As of June 30, 2005, plan membership totaled 215,016, comprised of 124,642 active members, 47,123 inactive members (includes terminated nonvested employees who are eligible for a refund), and 43,251 retirees and beneficiaries receiving benefits.

The state does not make any contributions to the University of California Retirement System. As of June 30, 2005, employee and employer contributions were not required to UCRP and PERS-VERIP, due to the fully funded status of each plan.

Set forth below is a summary of additions and deductions from the UC Regents Retirement Fund for the five fiscal years shown.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

TABLE 14

University of California Retirement Plan Fund
Schedule of Additions and Deductions
($ in thousands)*

	Fiscal Year Ended June 30,				
	2001	2002	2003	2004	2005
Contributions: Employer	$ 517	$ 118	$ 811	$ 5,150	$737
Contributions: Employee	4,405	2,954	7,060	2,503	1,653
Total Contributions	$ 4,922	$ 3,072	$ 7,871	$ 7,653	$2,390
Net Investment Income/(Losses) (including Appreciation)	(2,301,959)	(3,460,714)	1,892,384	4,998,664	3,982,916
Total Additions	(2,297,037)	(3,457,642)	1,900,255	5,006,317	3,985,306
Total Deduction (Benefits Paid and Administrative Expenses)	(903,981)	(970,453)	(1,015,248)	(1,145,469)	(1,315,466)
Net Assets as of the Beginning of the Fiscal Year	42,070,918	38,869,900	34,441,805	35,326,812	39,187,660
Net Assets as of the End of the Fiscal Year	38,869,900	34,441,805	35,326,812	39,187,660	41,857,500
Change in Net Assets	(3,201,018)	(4,428,095)	885,007	3,860,848	2,669,840

* Totals may not add up due to adjustments

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Set forth below is a schedule for funding projections for the UCRP for the five fiscal years shown. Actuarial information is based upon valuation performed as of the end of the fiscal year.

TABLE 15

University of California Retirement Plan Fund
Schedule of Funding Projections
($ in millions)

	Fiscal Year Ended June 30,				
	2001	2002	2003	2004	2005
Actuarial Value of Assets	$40,554	$41,649	$41,429	$41,293	$41,085
Actuarial Accrued Liabilities (AAL)-entry age	27,451	30,100	32,955	35,034	37,252
Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL)	13,103	11,549	8,474	6,259	3,833
Covered Payroll	6,539	7,227	7,734	7,835	8,150
Funded Ratio	147.7%	138.4%	125.7%	117.9%	110.3%

Source: University of California Retirement Plan Actuarial Valuation Report as of July 1, 2001, 2002, 2003, 2004 and 2005.

Post Retirement Benefits

The state also provides post-employment health care and dental benefits to its employees and their spouses and dependents, when applicable, and recognizes these costs on a "pay-as-you-go" basis. Table 16 shows the state's General Fund budget for post-employment benefits from fiscal years 2002-03 to 2006-07 and does not reflect any future liability for current employees or annuitants. It is anticipated that these costs will continue to grow in the future. As of June 30, 2006, approximately 137,583 retirees were enrolled to receive health benefits and 111,792 to receive dental benefits. The employer contribution for health premiums maintains the average 100/90 percent contribution formula established in the Government Code. Under this formula, the state averages the premiums of the four largest health benefit plans in order to calculate the maximum amount the state will contribute toward the retiree's health benefits. The state also contributes 90 percent of this average for the health benefits of each of the retiree's dependents. Employees vest for this benefit after serving ten years with the state. With ten years of service credit, employees are entitled to 50 percent of the state's full contribution. This rate increases by 5 percent per year and with 20 years of service, the employee is entitled to the full 100/90 formula.

TABLE 16

General Fund Budget for Post-Employment Benefits
Fiscal Years 2002-03 through 2007-08

Fiscal Year	Amount
2002-03	$ 576,620,000
2003-04	660,772,000
2004-05	795,554,000
2005-06	895,197,000
2006-07	1,019,368,000
2007-08	1,131,000,000

Source: Budget Acts of 2002-03, 2003-04, 2004-05, 2005-06 and 2006-07 and 2007-08 May Revision.

Although negotiations with insurance providers have not been completed, the 2007-08 May Revision includes a budgeted amount of $1.131 billion for post-employment benefits for fiscal year 2007-08, continuing the "pay as you go" policy which has been in effect. This amount was based in part on adoption by the CalPERS Board of requirements for increased copayments by plan members, which reduces the state's cost. CalPERS' staff have also recommended, and the CalPERS Board of Administration has adopted, guidelines specifying that health benefits should be increasing by no more than ten percent annually in the near term and the rate of growth should trend down to 4.5% over ten years. The Administration has also taken into account the estimate contained in the actuarial report described below of the state's cost for health care premiums for fiscal year 2007-08. Pending completion of a study due in January, 2008, the Administration has not proposed any method for pre-funding retiree health care costs.

On June 21, 2004, the Governmental Accounting Standard Board released its Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions ("Statement No. 45"). Statement No. 45 establishes standards for the measurement, recognition, and display of post-employment healthcare as well as other forms of post-employment benefits, such as life insurance, when provided separately from pension plan expenditures and related liabilities in the financial reports of state and local governments. Under Statement No. 45, governments will be required to: (i) measure the cost of benefits, and recognize other post-employment benefits expense, on the accrual basis of accounting in periods that approximate employees' years of service; (ii) provide information about the actuarial liabilities for promised benefits associated with past services and whether, or to what extent, the future costs of those benefits have been funded; and provide information useful in assessing potential demands on the employer's future cash flows. Statement 45 reporting requirements are effective for the state in the fiscal year beginning July 1, 2007. The state plans to include the actuarial computation of its liability for post-employment health care benefits in the 2007-08 financial statements.

The State Controller's Office entered into a contract with a private actuarial firm, Gabriel Roeder Smith & Company, to calculate the state's liability for these benefits. The report was released on May 7, 2007. The report was based on a variety of data and economic, demographic and healthcare trend assumptions concerning matters such as demographic trends and growth of health care costs which are described in the report. The actuarial evaluation covers the cost estimates for existing employees and retirees. The main objective of the report was to estimate the Actuarial Accrued Liability ("AAL"), which is the present value of future retiree healthcare costs attributable to employee service earned in prior fiscal years. The report looked at three different scenarios: (1) continuation of the "pay as you go" policy; (2) a "full funding" policy under which assets would be set aside to prepay the future obligations, similar to the way in which pension obligations are funded, and (3) a "partial funding" policy which was halfway between the two other scenarios. According to the actuarial valuation as of July 1, 2007, the current pay-as-you go funding policy results in an AAL of $47.88 billion, an annual required contribution of $3.59 billion, estimated employer contributions of $1.36 billion and an expected net OPEB ("other post employment benefits") obligation of $2.23 billion for the fiscal year ending June 30, 2008. The complete actuarial valuation report is available at: www.sco.ca.gov/eo/pressbox/2007/05/OPEB_actuaria_report.pdf.

The long-term costs for other post-employment benefits may negatively affect the state's financial reports and impact its credit ratings if the state does not adequately manage such costs.

Public Employee Post-Employment Benefits Commission

In late December 2006, the Governor created a Public Employee Post-Employment Benefits Commission, with a mandate to present a report to the Governor and the Legislature by January 1, 2008. The twelve members of the Commission were appointed on February 20, 2007. The Commission was directed to (i) identify, for the state and local governments, the amount and extent of unfunded post-employment retirement benefits, (ii) compare different approaches to address such unfunded benefits, (iii) consider the advantages from providing other post-employment benefits, and (iv) propose a plan or plans for addressing unfunded post-employment benefits. This Commission is the first step in fulfilling the Governor's commitment to examine the entire issue of post-employment benefits promised to employees of cities, counties, special districts, school districts, and the state, and propose a well-reasoned plan to pay for these benefits.

THE BUDGET PROCESS

General

The state's fiscal year begins on July 1 and ends on June 30 of the following year. The state's General Fund Budget operates on a legal basis, generally using a modified accrual system of accounting for its General Fund, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. Following the submission of the Governor's Budget, the Legislature takes up the proposal. As required by the Balanced Budget Amendment ("Proposition 58") and as described below, beginning with fiscal year 2004–05, the Legislature may not pass a budget bill in which General Fund expenditures exceed estimated General Fund revenues and fund balances at the time of the passage and as set forth in the budget bill.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of annual expenditure appropriations is the annual Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. See "THE BUDGET PROCESS—Constraints on the Budget Process" below. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Except as noted in the previous paragraph and in the next sentence, bills containing General Fund appropriations must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing appropriations for K-12 schools or community colleges ("K-14 education") only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation are not required to be in the State Treasury at the time an appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

Constraints on the Budget Process

Over the years, a number of laws and constitutional amendments have been enacted, often through voter initiatives, which have increased the difficulty of raising state taxes, restricted the use of the state's General Fund or special fund revenues, or otherwise limited the Legislature and the Governor's discretion in enacting budgets. Historic examples of provisions that make it more difficult to raise taxes include Proposition 13, passed in 1978, which, among other things, required that any change in state taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in computation, be approved by a two-thirds vote in each house of the Legislature. Examples of provisions restricting the use of General Fund revenues are Proposition 98, passed in 1988, which mandates that a minimum amount of General Fund revenues be spent on local education, and Proposition 10, passed in 1988, which raised taxes on tobacco products and mandated how the additional revenues would be expended. See "STATE FINANCES—Proposition 98" and "—Sources of Tax Revenue—Taxes on Tobacco Products."

More recently, a new series of Constitutional amendments sponsored by Governor Schwarzenegger and approved by the voters, have also affected the budget process. These include Proposition 58, approved in 2004, which requires the adoption of a balanced budget and restricts future borrowing to cover budget deficits, Proposition 1A, approved in 2004, which limits the Legislature's power over local revenue sources, and Proposition 1A approved at the November 7, 2006 election, which limits the Legislature's ability to use sales taxes on motor vehicle fuels for any purpose other than transportation. These recent constitutional amendments are described below.

Balanced Budget Amendment (Proposition 58)

Proposition 58, approved by the voters in 2004, requires the state to enact a balanced budget, and establish a special reserve in the General Fund and restricts future borrowing to cover fiscal year end deficits. As a result of the provisions requiring the enactment of a balanced budget and restricting borrowing, the state would in some cases have to take more immediate actions to correct budgetary shortfalls. Beginning with the budget for fiscal year 2004–05, Proposition 58 requires the Legislature to pass a balanced budget and provides for mid-year adjustments in the event that the budget falls out of balance and the Governor calls a special legislative session to address the shortfall. The balanced budget determination is made by subtracting expenditures from all available resources, including prior-year balances.

If the Governor determines that the state is facing substantial revenue shortfalls or spending increases, the Governor is authorized to declare a fiscal emergency. He or she would then be required to propose legislation to address the emergency, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the fiscal emergency within 45 days, the Legislature would be prohibited from: (i) acting on any other bills or (ii) adjourning in joint recess until such legislation is passed.

Proposition 58 also requires that a special reserve (the "Budget Stabilization Account" or "BSA") be established in the state's General Fund. Beginning with fiscal year 2006–07, a specified portion of estimated annual General Fund revenues would be transferred by the State Controller into the Budget Stabilization Account no later than September 30 of each fiscal year. These transfers would continue until the balance in the Budget Stabilization Account reaches $8 billion or 5 percent of the estimated General Fund revenues for that fiscal year, whichever is greater. The annual transfer requirement would be in effect whenever the balance falls below the $8 billion or 5 percent target. The annual transfers can be suspended or reduced for a fiscal year by an executive order issued by the Governor no later than June 1 of the preceding fiscal year. Proposition 58 also provides that one-half of the annual transfers shall be used to retire Economic Recovery Bonds, until a total of $5 billion has been used for that purpose. The 2007-08 May Revision proposes a transfer of $2.046 billion to the Budget Stabilization Account, of which $1.023 billion will be used to retire Economic Recovery Bonds. See "CURRENT STATE BUDGET – Proposed Fiscal Year 2007-08 Budget."

Proposition 58 also prohibits certain future borrowing to cover fiscal year end deficits. This restriction applies to general obligation bonds, revenue bonds, and certain other forms of long-term borrowing. The restriction does not apply to certain other types of borrowing, such as: (i) short-term borrowing to cover cash shortfalls in the General Fund (including revenue anticipation notes or revenue anticipation warrants currently used by the state), or (ii) inter-fund borrowings.

Local Government Finance (Proposition 1A of 2004)

As described under "STATE FINANCES—Local Governments" above, Senate Constitutional Amendment No. 4 (also known as "Proposition 1A"), approved by the voters in the November 2004 election, amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the state's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the state will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship and two–thirds of both houses of the Legislature approve the borrowing. The amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years. In addition, the state cannot reduce the local sales tax rate or restrict the authority of local governments to impose or change the distribution of the statewide local sales tax.

Proposition 1A also prohibits the state from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the state does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate on local governments to encompass state action that transfers to cities, counties and special districts financial responsibility for a required program for which the state previously had partial or complete responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges nor to mandates relating to employee rights.

Proposition 1A further requires the state to reimburse cities, counties, and special districts for mandated costs incurred prior to the 2004-05 fiscal year over a term of years. Chapter 72, Statutes of 2005 (AB 138) requires the payment of mandated costs incurred prior to 2004-05 to begin in 2006-07 and to be paid over a term of 15 years. The 2006 Budget Act appropriated $169.9 million, and the Legislature and the Administration specified that these funds include prepayment of the 2007-08 state mandate obligations. The remaining estimated cost of claims for mandated costs incurred prior to the 2004-05 fiscal year is $1.011 billion.

After School Education Funding (Proposition 49)

An initiative statute, Proposition 49, called the "After School Education and Safety Program of 2002," was approved by the voters on November 5, 2002, and requires the state to expand funding for before and after school programs in the state's public (including charter) elementary, middle and junior high schools. The increase was first required in 2006-07, which provided $550 million for these programs. The 2007 Budget Bill proposes to continue providing $550 million to be allocated as $547 million for grants for before and after school programs, and $3.0 million for administrative costs for the California State Department of Education. These funds are part of the Proposition 98 minimum funding guarantee for K-14 education and, in accordance with the initiative, cannot be reduced in future years unless the Proposition 98 guarantee is suspended. See "STATE FINANCES—Proposition 98".

Mental Health Services (Proposition 63)

On November 2, 2004 the voters approved Proposition 63, which imposes a 1 percent tax surcharge on taxpayers with annual taxable income of more than $1 million for purposes of funding and expanding mental health services. In addition, Proposition 63 prohibits the Legislature or the Governor from redirecting funds now used for mental health services to other purposes or from reducing General Fund support for mental health services below the levels provided in fiscal year 2003–04.

Transportation Financing (Proposition 1A of 2006)

On November 7, 2006 voters approved Proposition 1A, which had been placed on the ballot by the Legislature as Senate Constitutional Amendment No. 7, to protect Proposition 42 transportation funds from any further suspensions. Provisions of the State Constitution enacted as Proposition 42 in 2002, permitted the suspension of the annual transfer of motor vehicle fuel sales tax revenues from the General Fund to the Transportation Investment Fund if the Governor declared that the transfer would result in a "significant negative fiscal impact" on the General Fund and the Legislature agreed with a two-thirds vote of each house. The new measure modified the constitutional provisions of Proposition 42 in a manner similar to Proposition 1A of 2004, so that if such a suspension occurs, the amount owed by the General Fund must be repaid to the Transportation Investment Fund within three years, and only two such suspensions can be made within any ten-year period. In 2003-04, $868 million of the scheduled Proposition 42 transfer was suspended, and in 2004-05 the full transfer of $1.258 billion was suspended.

The Proposition 42 transfer was fully funded in 2005-06 at $1.359 billion. The 2006 Budget Act fully funds the Proposition 42 transfer at $1.419 billion for 2006-07, and also includes $1.415 billion ($1.215 billion General Fund) for advance repayment of a portion of the 2003-04 and 2004-05 suspensions. The 2007-08 May Revision proposes to fully fund the Proposition 42 transfer at $1.481 billion and the required repayment for remaining Proposition 42 debts at $83 million for 2007-08. See "CURRENT STATE BUDGET - 2007-08 Governor's Budget".

PRIOR FISCAL YEARS' BUDGETS

Fiscal Years Prior to 2005-06

The California economy grew strongly between 1994 and 2000, generally outpacing the nation, and as a result, for the five fiscal years from 1995–96 to 1999–00, the General Fund tax revenues exceeded the estimates made at the time the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid and to fund new ongoing program initiatives, including education spending above Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures. The state ended the 2000–2001 fiscal year with a budget reserve of $5.39 billion.

However, during fiscal year 2001–02, as the state and national economies fell into a recession and the stock markets dropped significantly, the state experienced an unprecedented drop in revenues compared to the prior year largely due to reduced personal income taxes from stock option and capital gains activity. During the three fiscal years between 2001-02 and 2003-04, the state encountered severe budgetary difficulties because of reduced revenues and failure to make equivalent reductions in expenditures, resulting in successive budget deficits. The budgets for these years included substantial reliance on one-time measures, internal borrowing, and external borrowing. The state also faced a cash flow crisis during this period which was relieved by the issuance of Revenue Anticipation Warrants in June 2002 and June 2003 and Economic Recovery Bonds in the spring of 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS."

While the 2004 Budget Act was aided by a recovering state economy and increased revenues, balancing of the budget still required a number of one-time actions. These included application of proceeds of the Economic Recovery Bonds sold in the spring of 2004 and of tobacco securitization bonds, and suspension of Proposition 42 transfer of certain sales taxes to transportation purposes. The 2004 Budget Act also used the second year of borrowing from local governments.

In summary, the 2004 Budget Act addressed a projected $13.9 billion budget shortfall through expenditure cuts ($4.0 billion or 28.7 percent), cost avoidance ($4.4 billion or 31.7 percent), fund shifts ($1.6 billion or 11.2 percent), loans or borrowing ($2.1 billion or 15.4 percent), and transfers and other revenue ($1.8 billion or 13.0 percent).

Final estimates relating to the 2004-05 fiscal year, as released in the 2006-07 Governor's Budget in January, 2006, show that the state experienced substantially more favorable results than were projected at the time the 2004 Budget Act was signed. As a result of revised estimates for years prior to 2004-05, tax amnesty payments (see below) and improved economic results which generated major increases in tax revenues, the Administration estimates that total prior year resources, plus revenues and transfers for 2004-05, were about $91.5 billion, more than $9.1 billion higher than originally estimated. Expenditures increased by about $1.1 billion. As a result, the fund balance at June 30, 2005 was estimated at about $9.6 billion, of which $9.1 billion was in the SFEU, compared to the original 2004 Budget Act estimate of $768 million in the SFEU.

Additional information about prior fiscal years' budgets for this period can be obtained from prior official statements of state bonds.

Tax Amnesty Program - Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior years. Penalties were waived for taxpayers who applied for the amnesty during the amnesty period of February 1, 2005 to March 31, 2005. The effect of amnesty on the accounting for General Fund revenues has been distortive since payments for years before the current year are accounted for as a "prior year adjustment" for the current year rather than being carried back to those earlier years. Additionally, since some payments were made in advance of future year payments the revenue estimates in the current year, the budget year, and beyond will be lower even though the payments received are accounted for as "prior year adjustments" to the current year. Moreover, much of the money that came in during the amnesty period was in the form of "protective payments," amounts submitted to avoid the extra penalty, but that would have otherwise been submitted in future years, or that will prove not to have been due at all, as some taxpayers will win their disputes. These refunds must be accounted for in future years.

For budgetary purposes, revenues from the amnesty program resulted in a carry-over adjustment increasing the beginning General Fund balance for fiscal year 2004-05 by $3.8 billion. This carry over adjustment was and will be reduced in fiscal year 2004-05 and subsequent fiscal years to account for refunds and the recognition of income over a period of time. The estimates of these adjustments has varied as more up-to-date information has been received, as reflected in differing estimates shown in the footnotes to Figure 1 below under "Fiscal Year 2005-06 revised estimates as of the 2007-08 Governor's Budget", and Figure 2 below under "CURRENT STATE BUDGET – 2006 Budget Act." The 2005 Budget Act estimated a net multi-year General Fund revenue gain from the amnesty program at $380 million, which represented a $180 million increase from the $200 million gain assumed at the time of the 2005-06 Governor's Budget. These amounts constituted one-time revenues that the 2005 Budget Act used for one-time purposes.

2005 Budget Act

The 2005 Budget Act was adopted by the Legislature on July 7, 2005, along with a number of implementing measures, and signed by the Governor on July 11, 2005. In approving the budget, the Governor vetoed $190 million in appropriations (including $115 million in General Fund appropriations).

Under the 2005 Budget Act, General Fund revenues and transfers were projected to increase 5.7 percent, from $79.9 billion in fiscal year 2004-05 to $84.5 billion in fiscal year 2005-06. The revenue projections assumed continued but moderating growth in California's economy as reflected in several key indicators. The 2005 Budget Act contained General Fund appropriations of $90.0 billion, compared to $81.7 billion in 2004-05. The difference between revenues and expenditures in fiscal year 2005-06 was funded by using a part of the $7.5 billion fund balance at June 30, 2005. The June 30, 2006 reserve was projected to be $1.302 billion, compared to an estimated June 30, 2005 reserve of $6.857 billion. About $900 million of this reserve was to be set aside for payment in fiscal year 2006-07 of tax refunds and other adjustments related to the tax amnesty program implemented in early 2005. The 2005 Budget Act also included special fund expenditures of $23.3 billion and bond fund expenditures of $4.0 billion. The state issued $3.0 billion of Revenue Anticipation Notes (RANs) to meet the state's short-term cash flow needs for fiscal year 2005-06.

The 2005 Budget Act contained the following major components:

1. Proposition 98 – General Fund expenditures increased by $2.582 billion, or 7.6 percent, to $36.6 billion. This reflected increases in the Proposition 98 guaranteed funding level resulting from

increases in General Fund revenues in fiscal year 2005-06, adjusted for changes in local revenues. The 2005 Budget Act fully funded enrollment growth and a 4.23 percent cost of living increase. Per pupil spending under Proposition 98 was projected to be $7,402, compared to $7,023 in the previous year. The 2005 Budget Act reflected savings of $3.8 billion in 2004-05, which would be restored to the Proposition 98 budget in future years as General Fund revenue growth exceeds personal income growth. See "STATE FINANCES—Proposition 98."

2. Higher Education – The 2005 Budget Act marked the first year of funding for the Higher Education Compact under this Administration. The Compact was signed in spring 2004 with both UC and CSU to provide funding stability for enrollment growth and basic support over the next six fiscal years. The 2005 Budget Act provided for total Higher Education funding of $17.8 billion from all revenue sources, including $10.2 billion General Fund. General Fund support for both the UC and CSU was increased by $134 million (about 5 percent) compared to 2004-05. The 2005 Budget Act assumed fee increases for undergraduate and graduate students, consistent with the Compact, which were approved by the UC and CSU governing boards.

3. Health and Human Services – The 2005 Budget Act increased General Fund expenditures by $2.1 billion, or 8.5 percent, to $27.1 billion for Health and Human Services programs. This increase consisted of higher Medi-Cal expenditures of $1.3 billion, Department of Developmental Services expenditures of $152 million, Department of Mental Health expenditures of $306 million, and Department of Social Services expenditures of $55 million, among other things. The 2005 Budget Act reflected the suspension of the July 2005 and July 2006 CalWORKs grant cost-of-living-adjustments (COLAs), yielding General Fund savings of $136 million in 2005-06 and $139 million in 2006-07. The 2005 Budget Act further assumed the January 2006 and January 2007 COLAs for SSI/SSP recipients would be suspended for estimated General Fund savings of $132 million in 2005-06, $407.5 million in 2006-07, and $281 million in 2007-08. The 2005 Budget Act also included federal fiscal relief of $223 million due to progress in implementing a single, statewide automated child support system.

4. Retirement and Employee Compensation – The 2005 Budget Act provided for full funding of the state's statutory obligations to the State Teachers' Retirement System ("CalSTRS"). The 2005 Budget Act also reflected an augmentation of $355 million for salary increases and dental and vision premium increases for certain bargaining units.

5. Vehicle License Fee Gap Loan Repayment – The 2005 Budget Act fully repaid the $1.2 billion that local governments lost between July and October of 2003, when the Vehicle License Fee offset program was temporarily suspended. The state was not required to repay the gap loan until August of 2006. This payment was made in August 2005.

6. Transportation Funding – The Proposition 42 transfer was fully funded at an estimated $1.3 billion.

7. Financial Instruments – The 2005 Budget Act reflected the state's issuance of pension obligation bonds to fund approximately $525 million of the state's 2005-06 retirement obligation to the California Public Employees' Retirement System, but an adverse court ruling prevented issuance of these bonds. See "LITIGATION – Matter Seeking Validation of Pension Obligation Bonds." The 2005 Budget Act reflected the results of the refinancing of the Golden State Tobacco Securitization Bonds, Series 2003B. In exchange for its continued backing of these bonds, the General Fund received $525 million in August 2005. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Pension Obligation Bonds" and "– Tobacco Settlement Revenue Bonds."

The original 2005-06 Governor's Budget had included a proposal to issue $464 million of judgment bonds to finance the pending settlement of the *Paterno* lawsuit (dealing with the state's liability for past flood damages), but subsequent developments led to the removal of this proposal from the budget. The state settled three related lawsuits through stipulated judgments. The largest settlement, in the amount of $428 million, provided for the state to make annual payments of $42.8 million per year, plus interest, for ten years; the payments are subject to annual appropriation by the Legislature. The first year's payment, as well as $36 million to fully discharge the other two stipulated judgments, was included in the 2005 Budget Act.

8. Taxes – The 2005 Budget Act contained no new taxes.

Fiscal Year 2005-06 revised estimates as of the 2007-08 Governor's Budget

Final estimates relating to the 2005-06 fiscal year, as released in the 2007-08 Governor's Budget in January, 2007, show that the state experienced substantially more favorable results than were projected at the time the 2005 Budget Act was signed. As a result of revised estimates for years prior to 2005-06 and improved economic results which generated major increases in tax revenues, the Administration estimates that total prior year resources, plus revenues and transfers for 2005-06, were about $93.4 billion, nearly $9.0 billion more than originally estimated. Expenditures increased by about $1.6 billion primarily for expenditures required by Proposition 98. As a result, the fund balance at June 30, 2006 was estimated at about $10.8 billion, of which $10.1 billion was in the SFEU, compared to the original 2005 Budget Act estimate of $1.3 billion in the SFEU.

Set forth below is a chart showing a General Fund Budget Summary for fiscal year 2005–06 as originally projected by the 2005 Budget Act, as subsequently revised by the 2006- Budget Act, and as further revised by the 2007-08 Governor's Budget.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Budget Summary for Fiscal Year 2005-06

FIGURE 1

2005–06 General Fund Budget Summary
($ Millions)

	As of 2005 Budget Act	As of 2006 Budget Act	As of 2007–08 Governor's Budget
Prior Year Resources Available	$7,498[(1)]	$9,511[(2)]	$8,981[(3)]
Revenues and Transfers	84,471	92,749	93,427
Expenditures	90,026	92,730	91,592
Fund Balance	$1,943	$9,530	$10,816
Reserve for Liquidation of Encumbrances	$641	$521	$745
Special Fund for Economic Uncertainties	$1,302[(4)]	$9,009[(5)]	$10,071[(6)]

(1) Included a carry-over adjustment of $2.33 billion from amnesty payments, of which $1.95 billion would have to be refunded or would reduce revenues in future years, including a $1.05 billion adjustment in fiscal year 2005-06, and $900 million in fiscal year 2006-07.

(2) Included a carry-over adjustment of $2.73 billion from amnesty payments, of which $2.35 billion will have to be refunded or will reduce revenues in future years, including a $730 million adjustment in 2005-06, $677 million adjustment in 2006-07 and $939 million in 2007-08 or later.

(3) Includes a carry-over adjustment of $2.82 billion from amnesty payments, of which $2.44 billion will have to be refunded or will reduce revenues in future years, including a $880 million adjustment in 2005-06, $860 million adjustment in 2006-07 and $700 million in 2007-08 or later.

(4) Included $900 million set aside for refunds/accelerations of amnesty related revenue in 2006-07.

(5) Included a carryover amount for refunds/acceleration of amnesty related revenue estimated to be $920 million, which is expected to be refunded over a longer period of time, beginning in 2007-08. See "PRIOR FISCAL YEARS' BUDGETS – Fiscal Years Prior to 2005-06 – Tax Amnesty Program".

(6) Includes a carryover amount for refunds/acceleration of amnesty related revenue estimated to be $700 million, which is expected to be refunded over a longer period of time, beginning in 2007-08. See "PRIOR FISCAL YEARS' BUDGETS – Fiscal Years Prior to 2005-06 – Tax Amnesty Program".

CURRENT STATE BUDGET

The discussion below of the fiscal year 2006-07 Budget, the fiscal year 2007-08 Governor's Budget, and the various tables under this section, are based on estimates and projections of revenues and expenditures for the 2006-07 and 2007-08 fiscal years and must not be construed as statements of fact. These estimates and projections are based upon various assumptions, which may be affected by numerous factors, including future economic conditions in the state and the nation, and there can be no assurance that the estimates will be achieved. See "— Revenue and Expenditure Assumptions."

2006 Budget Act

The 2006 Budget Act was adopted by the Legislature on June 27, 2006, along with a number of implementing measures, and signed by the Governor on June 30, 2006. In approving the budget, the Governor vetoed $112 million in appropriations (including $62 million in General Fund appropriations).

Under the 2006 Budget Act, General Fund revenues and transfers were projected to increase 1.2 percent, from $92.7 billion in fiscal year 2005-06 to $93.9 billion in fiscal year 2006-07. The 2006 Budget Act contained General Fund appropriations of $101.3 billion, compared to $92.7 billion in 2005-06. This included more than $4.9 billion, or 4.7 percent of total General Fund resources available, to address the state's debt by establishing a budget reserve of $2.1 billion and making early debt repayments of $2.8 billion. The difference between revenues and expenditures in 2006-07 was funded by using a large part of the 2006-07 beginning fund balance, as shown in Figure 2 below. The June 30, 2007 reserve was projected to be $2.1 billion, compared to an estimated June 30, 2006 reserve of $9.5 billion.

The 2006 Budget Act also contained Special Fund expenditures of $26.6 billion and Bond Fund expenditures of $3.6 billion. Special Fund revenues were estimated at $27.8 billion. Pursuant to the cash flow projections for the 2006 Budget Act, the state issued $1.5 billion of revenue anticipation notes to assist in its cash management program for the fiscal year.

The 2006 Budget Act was substantially similar to the 2006-07 May Revision proposals. Compared to the 2006-07 May Revision, however, it also assumed $299 million greater revenues for 2005-06 based on higher than expected revenues in May, and $19 million greater revenues in 2006-07 due to expanded sales tax licensing and collection programs. The 2006 Budget Act contained the following major General Fund components:

1. <u>Repayments and prepayments of prior obligations</u> – The 2006 Budget Act included $2.812 billion of repayments and/or prepayments of prior obligations as follows: (1) $1.415 billion for advance payment of a portion of the 2003-04 and 2004-05 Proposition 42 suspensions (includes $200 million pre-payment from a special fund); (2) $472 million for early retirement of the Economic Recovery Bonds under Proposition 58; (3) $296 million to repay/prepay non-Proposition 98 mandates; (4) $347 million to repay/prepay loans from special funds; (5) $150 million to prepay Proposition 98 Settle-Up (reflected in prior year and does not affect 2006-07 operating deficit); (6) $100 million to prepay flood control subventions; and (7) $32 million set aside to pay debt service on general obligation bonds in fiscal year 2007-08.

2. <u>Reduction of the operating deficit</u> – The 2006 Budget Act projected that after adjusting for repayments or prepayments of prior obligations and one-time investments, the net operating deficit would be $3.3 billion.

3. <u>Proposition 98</u> – The 2006 Budget Act included Proposition 98 General Fund expenditures at $41.3 billion, which was an increase of $2.9 billion, or 7.5 percent, compared to the

revised 2005-06 estimate. When property taxes were taken into account, the total Proposition 98 guarantee was $55.1 billion, which was an increase of $3.1 billion, or 5.9 percent. The 2006 Budget Act continued to propose to spend at the level of the Proposition 98 guarantee assuming that the 2004-05 suspension had only been $2 billion. It also continued to include $426 million above this level to implement Proposition 49. Furthermore, to resolve the pending lawsuit regarding Proposition 98 funding, the state agreed to calculate the Proposition 98 guarantee consistent with the legislative intent language contained in Chapter 213, Statutes of 2004. As a result, the state will pay $2.9 billion in settle-up funding, comprised of approximately $1.6 billion and $1.3 billion to count toward the Proposition 98 guarantees for 2004-05 and 2005-06, respectively (see "STATE FINANCES -- Proposition 98").

4. K-12 Education – The 2006 Budget Act included $67.1 billion in spending from all funds on K-12 education, an increase of $2.9 billion from the revised 2005-06 estimate. General Fund expenditures were set at $40.5 billion (including funds provided for prior year settle-up obligations), an increase of $2.7 billion, or 7 percent. Total per-pupil expenditures from all fund sources was projected to be $11,264, an increase of $516, or 4.8 percent from the revised 2005-06 level.

5. Higher Education – The 2006 Budget Act included General Fund expenditures at $11.4 billion, an increase of $973 million, or 9.4 percent. The 2006 Budget Act marked the second year of funding for the Higher Education Compact. The Compact was signed in Spring 2004 with both UC and CSU to provide funding stability and preserve educational quality over the following six fiscal years in exchange for improved accountability in a variety of key student performance measures. The 2006 Budget Act included additional funding of $75 million for UC and $54.4 million for CSU so that student fees in 2006-07 will remain at current 2005-06 levels.

6. Health and Human Services – The 2006 Budget Act included $29.3 billion General Fund to be spent on Health and Human Services programs, which was an increase of $2.5 billion, or 8.7 percent, from the revised 2005-06 estimate. This increase was primarily due to caseload, population, and other workload increases as well as a one-time investment of $214 million ($180 million General Fund) on health care surge capacity needs.

7. Transportation Funding – The 2006 Budget Act included $1.42 billion to fully fund Proposition 42 in 2006-07 and $1.415 billion, including interest, for advance payment of a portion of the 2003-04 and 2004-05 Proposition 42 suspensions ($200 million to be repaid from a special fund). The 2005 Budget Act assumed repayment of a portion of outstanding transportation loans with $1 billion in bond proceeds derived from certain Indian gaming revenues to specified transportation programs. This transportation funding package would have provided $465 million to the State Highway Account, $290 million to the Traffic Congestion Relief Program, $122 million to the Public Transportation Account, and $122 million to cities and counties. There have been several lawsuits that have prevented the bonds from being sold to date, and an Executive Order was issued in June 2006 to use the $151 million in tribal gaming compact revenues that had been received to repay a portion of these loans. Bond proceeds in the amount of $849 million were anticipated in the enacted 2006-07 Budget, which would have provided $314 million to the State Highway Account, and would provide the same level of funding to the Traffic Congestion Relief Program, Public Transportation Account, and cities and counties as was originally proposed. Due to the delays caused by ongoing litigation, the 2007-08 Governor's Budget anticipates expenditures of $100 million per year as revenues are received in 2006-07 and 2007-08, until the litigation is resolved. State law provides that these internal loans are not due and payable until funds are received from tribal gaming to repay them, thus there is no demand placed on the General Fund for repayment due to these developments. See "LITIGATION – Actions Seeking to Enjoin Implementation of or Cause Amendment to Certain Tribal Gaming Compacts" below.

8. Budget Stabilization Account – The 2006 Budget Act fully funded the transfer of $944 million to the Budget Stabilization Account (BSA), pursuant to Proposition 58. Half of this amount, or $472 million, will remain in the BSA as a reserve. The other half was transferred for the purpose of early retirement of Economic Recovery Bonds. These transfers took place in September, 2006.

Fiscal Year 2006-07 revised estimates in the 2007-08 Governor's Budget (as updated by the May Revision)

The 2007-08 May Revision revised various revenue and expenditure estimates for 2006-07. The 2007-08 May Revision projects that the state will end fiscal year 2006-07 with a total reserve of $3.688 billion, (including $472 million in the Budget Stabilization Account) up $1.586 billion from estimates made at the time of the 2006 Budget Act. The major changes are discussed below.

The prior year's resources balance reflects a net gain of $1.010 billion for 2006-07 at 2007-08 Governor's Budget since the 2006 Budget Act. This is made up of the following components:

- $702 million additional revenue in 2005-06;
- $838 million lower expenditures in 2005-06;
- $530 million decrease in resources prior to 2005-06

As of the 2007-08 May Revision, General Fund revenues and transfers for fiscal year 2006-07 are projected at $95.7 billion, an increase of $1.803 billion compared with 2006 Budget Act estimates. This increase is primarily due to the following:

- $1.358 billion higher Personal Income Tax;
- $210 million additional Corporation Tax

As of the 2007-08 May Revision, General Fund expenditures for fiscal year 2006-07 are projected at $102.3 billion, an increase of $1.0 billion compared with 2006 Budget Act estimates. This includes, among other things, the following significant adjustments since the 2006 Budget Act:

- $420 million of increased non-Proposition 98 expenditures due to costs related to newly bargained labor contracts and retirement rate adjustments;
- $350 million of increased non-Proposition 98 expenditures due to a shift of prison facility infrastructure funding from 2007-08 to 2006-07 due to the passage of AB 900.
- $279 million of increased non-Proposition 98 expenditures due to carryovers from 2005-06;
- $176 million of decreased non-Proposition 98 expenditures due to enrollment, caseload, and population adjustments;
- $103 million of decreased expenditures in Proposition 98 mainly due to a decline in average daily attendance and increased local property tax revenues.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Set forth below is a chart showing a General Fund Budget Summary for fiscal year 2006-07 as originally projected by the 2006 Budget Act, as subsequently revised by the 2007-08 Governor's Budget, and as further revised by the 2007-08 May Revision released on May 14, 2007.

FIGURE 2

2006-07 General Fund Budget Summary
(Millions)

	As of 2006 Budget Act	As of 2007-08 Governor's Budget	As of 2007-08 May Revision
Prior Year Resources Available	$9,530(1)	10,816 (2)	$10,540(3)
Revenues and Transfers	93,882	94,519	95,685
Expenditures	101,261	102,137	102,264
Fund Balance	$2,151	$3,198	$3,961
Reserve for Liquidation of Encumbrances	$521	$745	$745
Special Fund for Economic Uncertainties	$1,630	$2,453	$3,216
Budget Stabilization Account	$472	$472	$472
Total Available Reserve	$2,102	$2,925	$3,688

(1) Included a carry-over adjustment of $2 billion from amnesty-related payments, of which $1.62 billion will have to be refunded or will reduce revenues in future years, including a $677 million adjustment in 2006-07 and a $939 million adjustment in 2007-08 or later.

(2) Includes a carry-over adjustment of $1.94 billion from amnesty-related payments, of which $1.56 billion will have to be refunded or will reduce revenues in future years, including a $860 million adjustment in 2006-07 and $700 million adjustment in 2007-08 or later.

(3) Includes a carry-over adjustment of $2.14 billion from amnesty-related payments, of which $1.76 billion will have to be refunded or will reduce revenues in future years, including a $550 million adjustment in 2006-07 and $1.21 billion adjustment in 2007-08 or later.

Proposed Fiscal Year 2007-08 Budget (as updated by the May Revision)

The 2007-08 May Revision, released on May 14, 2007, projects to end fiscal year 2007-08 with a $2.2 billion total reserve, including $1.5 billion in the Budget Stabilization Account. General Fund revenues and transfers for fiscal year 2007-08 are projected at $101.3 billion, an increase of $5.6 billion compared with revised estimates for fiscal year 2006-07. The 2007-08 May Revision, among other assumptions, reflects an increase in 2007-08 major revenues of $4.4 billion, or 4.7 percent, due to continued economic growth and, to a lesser extent, certain revenue proposals described above under "STATE FINANCES – Sources of Tax Revenue." The 2007-08 May Revision also reflects a reduced amount of $314 million in revenues from Indian Gaming compacts that are pending legislative approval, $657 million of proceeds from refinancing of tobacco securitization bonds and $980 million of proceeds from the proposed sale of EdFund (described below).

General Fund expenditures for fiscal year 2007-08 are projected at $103.8 billion, an increase of $1.5 billion, or 1.5 percent, compared with the revised estimates for 2006-07. Most General

Fund spending is non-discretionary. Of the total spending proposed, $1.7 billion, or 2 percent, is for pre-paying debt and only $1.0 billion, or less than 1 percent is proposed for policy choices. The remainder is required either by the constitution, federal laws, statutory entitlements, binding labor agreements or court orders.

The 2007-08 May Revision has the following major General Fund components:

1. The proposed sale of EdFund -- The EdFund, California's student loan guarantee agency, competes in the private market as a student loan guarantor to banks and other financial institutions. EdFund does not offer direct student loans, set loan rates, or provide revenues to the General Fund. Student loan interest rates are regulated by the federal government; thus students will not be affected by this proposed transaction. The 2007-08 May Revision assumes a net one-time increase in revenue of $980 million from this sale.

2. Repayments and prepayments of prior obligations – The 2007-08 May Revision continues to propose $1.6 billion in prepayments of the Economic Recovery Bonds (ERBs) and $88 million of other budgetary debt repayments. This brings the total set aside to repay the ERBs to $7.4 billion in four years since the bonds were issued. As a result, the Department of Finance projects that the ERBs will be fully retired in November of 2009, which is 14 years ahead of schedule.

3. Net Operating Deficit in 2007-08 – Adjusted for ERB prepayments and other repayments, major non-structural costs, and the recognition of a major one-time gain, the 2007-08 May Revision estimates the 2007-08 net operating deficit at $1.4 billion while setting aside a budgetary reserve of $2.2 billion. The net operating deficit in 2007-08 was projected at $4.4 billion when the 2006-07 budget was enacted.

4. Proposition 98 – The 2007-08 May Revision includes Proposition 98 General Fund expenditures of $41.9 billion, which is an increase of $738 million, or 1.8 percent, compared to the revised 2006-07 estimate. When property taxes are taken into account, the total Proposition 98 guarantee is $57.6 billion, which is an increase of $2.2 billion, or 3.9 percent. The May Revision also continues to include $426 million above the 2006-07 Proposition 98 guarantee level to implement Proposition 49 (see "STATE FINANCES —Proposition 98").

5. K-12 Education – The 2007-08 May Revision includes $66.6 billion ($41.4 billion General Fund and $25.2 billion other funds) for K-12 education programs in 2007-08. This reflects an increase of $3.1 billion ($1.4 billion General Fund and $1.7 billion other funds). Total per-pupil expenditures are projected to increase by $322 to $11,562 in 2007-08, which includes funds for prior year settle-up obligations.

6. Higher Education – The 2007-08 May Revision reflects total funding of $19.7 billion, including $14.1 billion General Fund and Proposition 98 sources for all major segments of Higher Education (excluding infrastructure and stem cell research), which reflects an increase of $1.0 billion ($756.1 million General Fund and Proposition 98 sources) above the revised 2006 Budget Act. This includes funding for the compacts signed in 2004 with the University of California and the California State University.

7. Health and Human Services-- The 2007-08 May Revision includes $29.9 billion General Fund for Health and Human Services programs, which is an increase of $239 million from the revised 2006-07 estimate. Total funding from all state funds for Health and Human Services programs is $38.2 billion, which is an increase of $1.5 billion from the revised 2006-07 estimate. The major General Fund

workload adjustments required by law for 2007-08 include the following: (a) $1.4 billion for enrollment, caseload, and population driven program increases; (b) $185 million for statutorily required cost of living adjustments; and (c) $8.9 million to provide millions of low-income Californians with access to discounted prescription drugs. The 2007-08 Governor's Budget also includes $1.05 billion in General Fund expenditure reductions in Health and Human Services programs due to policy adjustments. Expenditure reductions include the following: (a) $314 million related to reforms in CalWORKs (the State's Welfare-to-Work Program); (b) $269 million for utilizing Proposition 98 funds for Stage 2 Child Care; (c) $129 million by using Public Transportation Account funding for regional centers; (d) $124 million for suspending the July 1, 2007 CalWORKs cost-of-living adjustment (COLA), and $185 million from suspending the January 2008 state Supplemental Security Income/State Supplemental Payment COLA.

8. Transportation Funding—The 2007-08 May Revision includes $1.48 billion to fully fund Proposition 42 in 2007-08. Proposition 1A was passed in November 2006 and provides for the repayment of any remaining Prop 42 debt by the year 2015-16. Pursuant to Proposition 1A, the Governor's Budget proposes to repay $83 million from the 2004-05 Proposition 42 suspension. Because the issuance of tribal gaming bonds continues to be delayed, the Governor's Budget also proposes to use the $100 million in tribal gaming compact revenues that will be received in 2006-07, 2007-08, and any future years until the bonds are sold, to repay past loans made from the State Highway Account, the Traffic Congestion Relief Fund, and the Public Transportation Account. Proposition 1B was also passed in November 2006, providing $19.925 billion in bonding authority for a total of 15 programs intended to address a broad range of transportation priorities including rehabilitation and expansion of highways, transit and transit security, port security, and air quality. The authority for the use of any bond funds must be provided for in the Budget Act. The 2007-08 May Revision proposes a total of $11.5 billion, with expenditures to be spread out over three years according to specified annual amounts.

9. Budget Stabilization Account--The 2007-08 May Revision provides for the transfer of $2.046 billion to the Budget Stabilization Account ("BSA"), the full amount pursuant to Proposition 58. Half of this amount, or $1.023 billion, will remain in the BSA as a rainy-day reserve. The other half will be transferred for the purpose of early retirement of Economic Recovery Bonds.

10. Lease of State Lottery – In the 2007-08 May Revision, the Governor proposed an examination of the potential benefits which could be derived from a lease of the State Lottery to private operators. The Governor indicated the belief that if private operators could substantially improve the returns from the Lottery – which currently operates below the national average in per capita receipts – the State may be able to realize substantial new income while still providing a guaranteed payment to schools. The Governor did not include any specific proposal in the 2007-08 May Revision, and did not include any increased revenue estimate based on such a transaction.

FIGURE 3

2007-08 General Fund Budget Summary
(Millions)

	As of 2007-08 Governor's Budget	As of 2007-08 May Revision
Prior Year Resources Available	$3,198 [(1)]	$3,961 [(2)]
Revenues and Transfers	$101,278	$101,253
Expenditures	$103,141	$103,765
Fund Balance	$1,335	$1,449
Reserve for Liquidation of Encumbrances	$745	$745
Special Fund for Economic Uncertainties	$590	$704
Budget Stabilization Account	$1,495	$1,495
Total Available Reserve	$2,085	$2,199

(1) Includes a carry-over adjustment of $1.08 billion from amnesty-related payments, of which $700 million will have to be refunded or will reduce revenues in future years, including a $360 million adjustment in 2007-08 and $340 million in 2008-09 or later. See "PRIOR FISCAL YEARS' BUDGETS –Fiscal Years Prior to 2005-06 – Tax Amnesty Program."

(2) Includes a carry-over adjustment of $1.59 billion from amnesty-related payments, of which $1.21 billion will have to be refunded or will reduce revenues in future years, including a $610 million adjustment in 2007-08 and $600 million in 2008-09 or later. See "PRIOR FISCAL YEARS' BUDGETS –Fiscal Years Prior to 2005-06 – Tax Amnesty Program."

Following the release of the 2007-08 Governor's Budget, a labor arbitration award was made in favor of the prison guard's union (see "OVERVIEW OF STATE GOVERNMENT –Employee Relations" below). This award will result in net General Fund costs of $147.5 million above amounts which the Administration had previously assumed for this arbitration.

California Strategic Growth Plan

In May 2006, the Legislature approved a $115.8 billion Strategic Growth Plan (SGP) package, which included $37.3 billion in new general obligation bonds which were approved by the voters at the November 7, 2006 election, $50.1 billion in existing funding, and $28.4 billion in new leveraged funding sources. In addition, California voters approved a $5.4 billion bond initiative for natural resource protection, water, and parks. The 2007-08 Governor's Budget proposes appropriation of $13.7 billion of the recently approved bonds to immediately begin building California for future generations.

To complete the SGP, the Administration proposes additional funding for critical infrastructure improvement between now and 2016. Thus, the 2007-08 Governor's Budget proposed a combination of new general obligation ($29.4 billion), lease-revenue ($9.8 billion) and self-liquidating revenue bonds ($2.0 billion) totaling $41.2 billion to finance the SGP through 2016. As modified in the 2007-08 May Revision, the SGP has the following components:

- $7.4 billion for state and local correctional facilities – this portion of the SGP was implemented by enactment of Chapter 7, Statutes of 2007, described further below under "Prison Construction Program";

- $11.6 billion for K-12 education facilities;

- $11.6 billion for Higher Education facilities;

- $6.0 billion for water supply and management;

- $2.0 billion for the state's judiciary facilities; and

- $2.6 billion for other public service infrastructure

The SGP proposes that the new general obligation bonds be placed on the ballot in the 2008 and 2010 elections. Combined with the bonds already approved by the voters, other existing funding sources and leveraged funding through the use of public private partnerships, total funding for the SGP will be $210 billion.

While high speed rail could eventually be shown to be a cost-effective piece of the state's long distance travel system, the Administration believes that benefits are not sufficient to outweigh the immediate needs included in the SGP. Therefore, the Administration is proposing to defer the High Speed Rail bonds indefinitely and will explore alternative project delivery approaches for the longer term.

Prison Construction Program

On May 3, 2007, the Governor signed AB 900 (Chapter 7, Statutes of 2007) ("AB 900"), which provides for a critical expansion of capacity in the state prison system and additional funds for county jails. In addition to construction funding, AB 900 emphasized expanding rehabilitative programs and measuring outcomes through performance goals to reduce the high rate of recidivism among adult offenders.

The central feature of AB 900 is authorization for issuance of a total of up to $7.4 billion of lease-revenue bonds by the State Public Works Board in two phases. Prison Phase I, which may be implemented immediately, authorizes approximately $3.6 billion to finance (i) 12,000 new state prison beds to replace temporary housing for inmates in public spaces not designed for such uses, (ii) 6,000 beds for the incarceration of inmates who have served the majority of their terms in re-entry facilities near the communities into which they will eventually be released, and (iii) 6,000 medical, dental and mental health spaces. Prison Phase II may be implemented after a designated 3-member panel certifies that about 1/3 of the spaces specified in State Phase I are under construction. Prison Phase II, which must be commenced by January 1, 2014, authorizes up to approximately $2.5 billion for (i) an additional 4,000 beds at existing state prisons, (ii) an additional 2,000 medical, dental and mental health beds, and (iii) an additional 10,000 spaces in re-entry housing.

AB 900 also authorizes funding for acquisition, design and construction of county jail facilities, subject to a 25% local match and certain designated priorities and standards. Jail Phase I consists of up to $750 million of lease revenue bonds, which must be issued by June 30, 2017. Upon certification that certain benchmarks are met for commencement of construction under Jail Phase I and State Phase I, up to $470 million in additional funds for county jails will be available under Jail Phase II.

In addition to authorization for new bonds, AB 900 appropriated $50 million for the Department of Corrections and Rehabilitation ("CDCR") to expand rehabilitative programs and $300 million to complete various infrastructure and capacity improvements. These increased expenditures are included in the 2007-08 May Revision as adjustments to fiscal year 2006-07.

The 2007-08 May Revision does not include funding for all of the potential fiscal impacts associated with AB 900. The Governor has convened multi-disciplinary "Strike Teams" to review and make recommendations on the programmatic and construction-related aspects of AB 900 implementation. Once the Strike Teams have evaluated the fiscal implications of AB 900, implementation plans and resource needs beyond those appropriated in AB 900 will be presented to the Legislature.

The 2007-08 May Revision includes the following expenditures related to prison reform:

- An increase of $11.7 million General Fund in 2007-08 and $27.8 million in 2008-09 to fill vacant teacher positions in adult institutions. By filling teacher vacancies, the CDCR will be able to provide educational and vocational services to an additional 6,372 inmates annually.

- An increase of $9.6 million in 2007-08 and $14.6 million in 2008-09 to reflect the transfer of up to 5,060 inmates to correctional facilities in other states. AB 900 authorizes these transfers, and this will provide immediate relief for overcrowding in the prison system and enhance the safety of the conditions under which employees work and inmates are housed.

- An increase of $581,000 General Fund for the CDCR's Office of Facilities Management to provide immediate staffing needs to support the prison construction projects authorized by AB 900 and $2 million General Fund for the Corrections Standards Authority to administer the jail construction authorized by AB 900.

LAO Assessment of the 2007-08 Governor's Budget Proposals

The Legislative Analyst's Office ("LAO") has released several reports which include their estimates and assessments of the 2007-08 Governor's Budget and May Revision and associated fiscal and economic projections. These include a report titled "California Fiscal Outlook – LAO Projections 2006-07 through 2011-12" dated November 15, 2006, a report titled "Overview of the Governor's Budget" dated January 12, 2007, a report titled "The 2007-08 Budget: Perspectives and Issues" released on February 21, 2007, and a report dated May 15, 2007 titled "Overview of the 2007-08 May Revision" ("Overview").

In the most recent Overview report, the LAO has the following statements in its summary at the beginning of the report (boldface as in the original report):

"LAO Comments

Revenue Estimate Reasonable. The administration's revenue forecast for the state's major revenues is reasonable. While our estimates for individual taxes differ from the administration's, offsetting forecasts result in similar totals.

Reserve Likely Overstated by $1.7 Billion. The May Revision makes a number of optimistic assumptions about its proposals—such as the legality of its public transit proposal, its estimates of gambling and property tax revenues, and assumed savings from midyear reductions. In total, we estimate that the Governor's reserve is likely overstated by $1.7 billion, and the May Revision would leave only a $529 million reserve. This reduced reserve would be subject to additional risks and cost pressures.

Out-Year Problem has Worsened. We estimate that, under the Governor's proposals, state expenditures would exceed revenues by more than $3 billion in 2007-08. This shortfall would grow to more than $5 billion in 2008-09 due to a number of one-time solutions contained within the May Revision."

In its analysis of the economic assumptions in the 2007-08 May Revision, the LAO reported:

"The economic and revenue outlooks face two main uncertainties. First is the economic uncertainties associated with the outlook for the housing market in light of recent sales declines, foreclosures, and price reductions. The second is the future path of crude oil and retail gasoline prices. Adverse developments in these areas could significantly impact both overall economic performance and state revenues. Likewise, key elements of the revenue base, such as capital gains and stock options, are highly volatile and, therefore, difficult to predict."

Elsewhere in its report, the LAO advises the Legislature that the Administration's proposals to sell the EdFund and to lease the State Lottery are worth further consideration.

Publications from the LAO can be read in full by accessing the LAO's website (www.lao.ca.gov) or by contacting the LAO at (916) 445-4656.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Summary of State Revenues and Expenditures

The table below presents the actual revenues, expenditures and changes in fund balance for the General Fund for fiscal years 2003–04, 2004-05, and 2005-06, estimated results for fiscal year 2006-07 and a projection for fiscal year 2007-08 based on the 2007-08 May Revision.

TABLE 17

Statement of Revenues, Expenditures, And Changes in Fund Balance–General Fund (Budgetary Basis)[a] Fiscal Years 2003–04 Through 2007–08 (Millions)

	2003–04	2004–05	2005–06	Estimated[b] 2006–07[c]	Proposed[b] 2007-08[c]
Fund Balance–Beginning of Period	$ (7,536.2)	$ 3,309.4	$ 9,922.7	$ 11,255.5	$3,961.5
Restatements					
Prior Year Revenue, Transfer Accrual Adjustments[d]	2,626.1	3,785.4	(730.0)	(441.5)	--
Prior Year Expenditure, Accrual Adjustments	512.7	313.7	122.3	(273.6)	--
Fund Balance–Beginning of Period, as Restated	$ (4,397.4)	$ 7,408.5	$ 9,315.0	$10,540.4	$3,961.5
Revenues	$74,149.8	$81,980.0	$93,883.1	$95,721.6	$101,528.5
Other Financing Sources					
Economic Recovery Bonds[e]	11,254.0	–	–	–	
Transfers from Other Funds	914.8	359.9	783.7	(36.2)	(275.1)
Other Additions	124.9	83.8	187.7	–	–
Total Revenues and Other Sources	$86,443.5	$82,423.7	$94,854.5	$95,685.3	$101,253.4
Expenditures					
State Operations	$19,498.2	$17,966.1[f]	$21,357.5	$24,392.4	$26,128.7
Local Assistance	58,610.8	61,674.4	69,278.2	74,136.5	74,289.7
Capital Outlay	348.7	65.1	1,451.3	629.4	299.7
Unclassified	–		--	3,105.8	3,047.7
Other Uses					
Transfer to Other Funds	279.0	203.9	827.0[g]	–[g]	–[g]
Total Expenditures and Other Uses	$78,736.7	$79,909.5	$92,914.0	$102,264.1	$103,765.8
Revenues and Other Sources Over or (Under) Expenditures and Other Uses	$ 7,706.8	$2,514.2	$1,940.5	$(6,578.8)	$(2,512.4)
Fund Balance					
Reserved for Encumbrances	$ 641.4	$ 540.4	$ 691.6	$ 744.9	$ 744.9
Reserved for Unencumbered Balances of Continuing Appropriations[h]	902.1	858.7	1,294.3	--	--
Unreserved–Undesignated [i]	1,765.9	8,523.6	9,269.6	3,216.6	704.2
Fund Balance–End of Period	$ 3,309.4	$9,922.7	$11,255.5	$ 3,961.5	$1,449.1

Footnotes on following page.

Source: Fiscal years 2003-04 to 2005-06: State of California, Office of the State Controller.
Fiscal years 2006-07 and 2007-08: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with state law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The Supplementary Information contained in the state's Audited Basic Financial Statements for the year ended June 30, 2005, incorporated by reference in this APPENDIX A, contains a description of the differences between the budgetary basis and the GAAP basis of accounting and a reconciliation of the June 30, 2005 fund balance between the two methods. See "FINANCIAL STATEMENTS."
(b) Estimates are shown net of reimbursements and abatements.
(c) Estimated as of the 2007-08 May Revision, May 14, 2007.
(d) Figures for fiscal years 2003–04 and 2004-05 are higher due to a change in accounting for prior year revenues collected by the Franchise Tax Board ("FTB") for the Voluntary Compliance Initiative revenue. FTB now recognizes audit findings as prior year revenue collected.
(e) Reflects the issuance of economic recovery bonds sufficient to provide net proceeds to the General Fund of $11.254 billion in 2003–04 to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds." $2.012 billion of this amount is budgeted as an expenditure reduction in fiscal year 2004–05.
(f) Reflects General Fund payment offsets from moneys deposited in the Deficit Recovery Fund ($2.012 billion).
(g) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfers from Other Funds."
(h) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, see Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2007-08 May Revision includes the unencumbered balances of continuing appropriations as a footnote to the statement ($1,149.2 million in fiscal year 2005-06, $399.9 million in fiscal year 2006-07, and $0 in fiscal year 2007-08). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the encumbered balance for continuing appropriations.
(i) Includes Special Fund for Economic Uncertainties ("SFEU"). The Department of Finance generally includes in its estimates of the SFEU and set aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," and "Unreserved—Undesignated." The Department of Finance estimates a $3,216.6 million SFEU balance on June 30, 2007, and projects a $704.2 million SFEU balance on June 30, 2008, based upon the 2007-08 May Revision as of May 14, 2007. In addition to the SFEU, there is projected to be an additional reserve of $472 million in the Budget Stabilization Account (BSA) as of June 30, 2007, and $1,495 million as of June 30, 2008, available to transfer to the General Fund through statute. The total available reserve, including the BSA, is projected to be $3.688 billion as of June 30, 2007 and $2.199 billion as of June 30, 2008. The BSA was created pursuant to the California Balanced Budget Act (Proposition 58), enacted in 2004.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 2005-06 fiscal year and the 2007-08 May Revision estimates for the 2006-07 and 2007-08 fiscal years.

TABLE 18

Major General Fund Revenue Sources and Expenditures

	Revenues (Millions) Fiscal Years			
Source	**2005-06[(a)] Actual**	**2006-07[(b)] Enacted**	**2006-07[(c)] Revised**	**2007-08[(c)] Proposed**
Personal Income Tax	$49,901	$50,885	$52,243	$55,236
Sales and Use Tax	27,581	28,114	27,787	28,841
Corporation Tax	10,316	10,507	10,717	11,053
Insurance Tax	2,202	2,340	2,166	2,181
All Other	3,451	2,036[(d)]	2,772[(d)]	3,942[(e)]
Total Revenues and Transfers	$93,451	$93,882	$95,685	$101,253

	Expenditures (Millions) Fiscal Years			
Function	**2005-06[(a)] Actual**	**2006-07[(b)] Enacted**	**2006-07[(c)] Revised**	**2007-08[(c)] Proposed**
K-12 Education	$37,368	$40,510	$40,197	$41,367
Health and Human Services	26,342	29,304	29,668	29,907
Higher Education	10,266	11,368	11,441	11,994
Corrections and Rehabilitation	7,783	8,751	9,385	9,969
Legislative, Judicial and Executive	3,053	3,417	3,522	3,864
Tax Relief[(f)]	668	679	682	650
Resources	1,477[(g)]	1,826[(h)]	2,096[(i)]	1,687[(j)]
State and Consumer Services	552	576	613	576
Business, Transportation and Housing	1,727[(k)]	3,029[(l)]	3,019[(m)]	1,650[(n)]
All Other	2,356[(o)]	1,801[(p)]	1,641[(p)]	2,101[(q)]
Total Expenditures	$91,592	$101,261	$102,264	$103,765

Source: State of California, Department of Finance. Figures in this table may differ from the figures in Table 4; see "Note" to Table 4.

(a) 2007-08 Governor's Budget, January 10, 2007.
(b) 2006-07 Budget Act, June 30, 2006.
(c) 2007-08 May Revision, May 14, 2007.
(d) Includes $472 million (budgeted as a revenue reduction) transferred to the Budget Stabilization Account to remain in the rainy day fund and $600 million from refinancing of tobacco securitization bonds.
(e) Includes $980 million for the sale of the EdFund, $657 million due to the refinancing of the tobacco securitization bonds, and includes $1.023 billion (budgeted as a revenue reduction) transferred to the Budget Stabilization Account to remain in the rainy day fund.
(f) Reflects the elimination of VLF "backfill" payments to local governments.
(g) Reflects $115 million for levee evaluation and flood control system improvements

Footnotes continue on following page.

(h) Reflects $355 million for levee evaluation and flood control system improvements
(i) Reflects $187 million for levee evaluation and flood control system improvements
(j) Reflects $30 million for levee evaluation and flood control system improvements
(k) Reflects $1.359 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund.
(l) Reflects $1.420 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund and $1.215 million partial early repayment of the 2003-04 and 2004-05 Proposition 42 suspensions.
(m) Reflects $1.419 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund and $1.215 million partial early repayment of the 2003-04 and 2004-05 Proposition 42 suspensions.
(n) Reflects $1.481 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund $83 million partial early repayment of the 2003-04 and 2004-05 Proposition 42 suspensions.
(o) Reflects $1.187 billion to fully repay the amount that local governments lost between July and October 2003 when the Vehicle License Fee offset program was temporarily suspended; assumes no pension obligation proceeds.
(p) Reflects $472 million transfer to the Budget Stabilization Account for early retirement of the Economic Recovery Bonds.
(q) Reflects $1,023 billion transfer to the Budget Stabilization Account for early retirement of the Economic Recovery Bonds.

Development of Revenue Estimates

The development of the forecast for the major General Fund revenues begins with a forecast of national economic activity prepared by an independent economic forecasting firm. The Department of Finance's Economic Research Unit, under the direction of the Chief Economist, adjusts the national forecast based on the Department's economic outlook. The national economic forecast is used to develop a forecast of similar indicators for California activity.

After finalizing the forecasts of major national and California economic indicators, revenue estimates are generated using revenue forecasting models developed and maintained by the Department of Finance. With each forecast, adjustments are made for any legislative, judicial, or administrative changes, as well as for recent cash results. The forecast is updated twice a year and released with the Governor's Budget by January 10 and the May Revision by May 14.

Economic Assumptions

The revenue and expenditure assumptions set forth above have been based upon certain estimates made as of April 2007 of the performance of the California and national economies in calendar years 2007 and 2008. In the 2007–08 May Revision, the Department of Finance projected that the California economy will decelerate in calendar year 2007 before rebounding in calendar year 2008. Economic growth will likely be modest in the first half of 2007, and unemployment could increase slightly. The second half of the year should bring modestly better growth as the state housing sector downturn begins to abate.

Cooling housing sectors continued to slow the national and California economies in the first quarter of 2007. A drop in home building was instrumental in reducing growth in real GDP to 1.3 percent, the slowest pace in over four years, and extending a deceleration in economic output that began in the second quarter of 2006. In California, reduced home building likely contributed to a slowdown in taxable sales growth. The downturn in the national and California housing sectors will likely last longer than anticipated in the Governor's Budget forecast

Consumer spending grew by 3.8 percent and government spending by 1 percent in the national economy in the first quarter, but fixed investment and net exports fell and businesses worked down inventories. Retail sales fell in April, however, although unseasonable weather and an early Easter may have played a role in the decline.

Job gains shrank in the nation in the first five months of 2007, averaging 133,000 per month. In 2006, the average monthly gain was 189,000. The national unemployment rate has settled at about 4.5

percent. Tight labor markets have resulted in average weekly earnings gains of about 4 percent over a year ago.

Energy prices increased in the first five months of 2007, with the average price for regular-grade gasoline breaching $3 per gallon and crude oil prices $65 per barrel. These increases boosted broad measures of inflation in the economy, but measures of inflation that exclude energy prices eased somewhat.

California personal income grew by an estimated 6.1 percent in 2006, somewhat stronger than in 2005. Growth in taxable sales, however, fell to 3.9 percent in 2006 from 7.4 percent in 2005. New vehicle registrations fell in 2006 and likely played a role in the slowdown in taxable sales. New vehicle registrations also were down from a year ago in the first two months of 2007.

California home building and residential real estate markets slowed in 2006. The number of residential units permitted fell 22 percent, as compared to 15 percent for the nation. Permits increased in the first quarter of 2007, however. Existing, single-family detached home sales fell 24 percent in 2006, and home price appreciation moderated.

Private-sector nonresidential construction increased by 8.8 percent in California in the first quarter of 2007 with the largest gains coming in office and store construction and alterations and additions.

California began 2007 with a job loss in January, but February, March, and April brought job gains. The annual benchmark revision of employment statistics in March revealed that considerably more jobs were created in the state during 2006 than were initially reported. The state added 275,000 jobs in 2006, the best gain since 2000. Nine out of the 11 major industry sectors saw employment grow in 2006. The state's unemployment rate averaged 4.9 percent in 2006 and was 4.8 percent in each of the first three months of 2007 before increasing to 5.1 percent in April. Job growth improved in the San Francisco Bay Area, giving the region the strongest percentage job growth of major California regional economies in 2006.

The Department of Finance sets out the following estimates for the state's economic performance in calendar years 2007 and 2008, which were used in predicting revenues and expenditures for the 2007-08 May Revision Budget. Also shown is the Department of Finance's previous forecast for the same calendar years, which was contained in the 2007-08 Governor's Budget Forecast.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

TABLE 19

Estimates of State's Economic Performance

	For Calendar Year 2007		For Calendar Year 2008	
	2007-08 May Revision[(a)]	**2007–08 Governor's Budget[(b)]**	**2007-08 May Revision[(a)]**	**2007–08 Governor's Budget[(b)]**
Non-farm wage and salary employment (000)	15,257	15,242	15,485	15,490
Percent Change	1.3%	1.2%	1.5%	1.6%
Personal income ($ billions)	$1,492	$1,502	$1,573	$1,583
Percent Change	5.3%	5.7%	5.5%	5.4%
Housing Permits (Units 000)	133	152	143	165
Consumer Price Index (percent change)	2.8%	2.6%	2.6%	2.4%

(a) 2007-08 May Revision, May 14, 2007.

(b) Fiscal Year 2007–08 Governor's Budget Summary: January 10, 2007.

Source: State of California, Department of Finance.

FINANCIAL STATEMENTS

The Audited Annual Financial Statements of the State of California for the Year Ended June 30, 2006 (the "Financial Statements") are available and are incorporated by reference into this APPENDIX A. The Financial Statements consist of an Independent Auditor's Report, a Management Discussion and Analysis, Basic Financial Statements of the state for the Year Ended June 30, 2006 ("Basic Financial Statements"), and Supplementary Information. Only the Basic Financial Statements have been audited, as described in the Independent Auditor's Report. A description of the accounting and financial reporting standards set by the Governmental Accounting Standards Board and used in the Basic Financial Statements is contained in Note 1 of the Basic Financial Statements.

A copy of the Financial Statements may also be obtained or reviewed from the following sources:

1. By obtaining, from any Nationally Recognized Municipal Securities Information Repository, or from any other source, a copy of the State of California's Official Statement dated March 28, 2007 for $4,096,410,000 General Obligation Refunding Bonds. The Financial Statements are printed in full in such Official Statement. No other part of the March 28, 2007 Official Statement is incorporated into this documents except the Financial Statements.

2. By accessing the internet website of the State Controller (www.sco.ca.gov) and selecting "Publications" and then selecting "State Government Annual Financial Reports," or by contacting the Office of the State Controller at (916) 445-2636.

3. By accessing the internet website of the State Treasurer (www.treasurer.ca.gov) and under the heading "Inside the Treasurer's Office" selecting "Bonds – Public Finance," and then under the heading "Financial Information," selecting "Recent Financial Information" or by contacting the Office of the State Treasurer at (800) 900-3873.

The State Controller's unaudited reports of cash receipts and disbursements for the period from July 1, 2006 through April 30, 2007, are included as Exhibit 1 to this APPENDIX A. These reports are available on the State Controller's website.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The State Controller issues a monthly report on cash receipts and disbursements recorded on the State Controller's records. The Department of Finance issues a monthly bulletin, available by accessing the internet website of the Department of Finance (www.dof.ca.gov), which reports the most recent revenue receipts as reported by state departments, comparing those receipts to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at the time of budget enactment. These bulletins and reports are available on the internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into the Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in the Official Statement from the Department of Finance concerning monthly receipts of "agency cash" may differ from the State Controller's reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

INVESTMENT OF STATE FUNDS

Moneys on deposit in the State's Centralized Treasury System are invested by the State Treasurer in the Pooled Money Investment Account ("PMIA"). As of April 30, 2007, the PMIA held approximately $45 billion of state moneys, and $19.5 billion invested for about 2,601 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of April 30, 2007, are shown in the following table:

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

TABLE 20

Analysis of the Pooled Money Investment Account Portfolio*

Type of Security	Amount (Thousands)	Percent of Total
U.S. Treasury	$4,412,782	6.8%
Commercial Paper	13,064,934	20.3
Certificates of Deposits	15,999,555	24.8
Corporate Bonds	466,015	0.7
Federal Agency	13,423,485	20.8
Bankers Acceptances	--	0.0
Bank Notes	1,810,007	2.8
Loans Per Government Code	7,378,751	11.4
Time Deposits	8,550,495	13.3
Repurchases	--	0.0
Reverse Repurchases	(596,294)	(0.9)
	$64,509,730	100%

* Totals may differ due to rounding.

Source: State of California, Office of the State Treasurer.

The state's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB. The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The State Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of April 30, 2007 was 166 days.

OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the state voters may directly influence state government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on state finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles. See "FINANCIAL STATEMENTS."

The Governor is the chief executive officer of the state and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, state law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

Office	**Name**	**Party Affiliation**	**First Elected**
Governor	Arnold Schwarzenegger	Republican	2003
Lieutenant Governor	John Garamendi	Democrat	2006
Controller	John Chiang	Democrat	2006
Treasurer	Bill Lockyer	Democrat	2006
Attorney General	Edmund G. Brown Jr.	Democrat	2006
Secretary of State	Deborah Bowen	Democrat	2006
Superintendent of Public Instruction	Jack O'Connell	Democrat	2002
Insurance Commissioner	Steve Poizner	Republican	2006

The executive branch is principally administered through eleven major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Labor and Workforce Development Agency, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs and Department of Corrections and Rehabilitation. In addition, some state programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over certain functions of state government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three segments: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 55,300 degrees were awarded in the 2005-06 school year. Approximately 212,500 full-time students were enrolled at the ten UC campuses and the Hastings College of Law in the 2006-07 school year. (The newest campus, at Merced, opened to graduate students in 2004, and to undergraduates in the fall of 2005.) The California State University System provides undergraduate and graduate degrees to students. Approximately 87,700 degrees were awarded in the 2005-06 school year. About 348,300 full-time students were enrolled at the 23 campuses in the 2006-07 school year. The third sector consists of 110 campuses operated by 72 community college districts, which provide associate degrees and certificates to students. Additionally students may attend community colleges to meet basic skills and other general education requirements prior to transferring to a four-year undergraduate institution. More than 120,000 associate degrees and certificates were awarded in the 2005-06 school year. Almost 1.6 million students were enrolled in California's community colleges in the spring of 2006.

Employee Relations

In 2005–06, the state work force was comprised of approximately 334,000 positions, of which approximately 116,000 positions represented employees of institutions of higher education. Of the remaining 218,000 positions, approximately 182,000 were subject to collective bargaining and approximately 36,000 were excluded from collective bargaining. State law provides that state employees, defined as any civil service employee of the state and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board ("PERB") to appoint a mediator.

There are twenty-one collective bargaining units that represent state employees. Of the twenty-one bargaining units, twenty have negotiated new contracts; one contract expires in July 2007, eighteen contracts expire in July 2008, and one contract expires in July 2010. The California Correctional Peace Officers Association ("CCPOA") is the only bargaining unit without a contract; its members continued under the terms of the prior agreement. The Department of Personnel Administration ("DPA") is continuing to negotiate with the CCPOA.

The state has not experienced a major work stoppage since 1972. The Service Employees International Union is the exclusive representative for nine of the twenty-one collective bargaining units, or approximately 50 percent of those represented employees subject to collective bargaining. The International Union of Operating Engineers is the exclusive representative for two of the twenty-one collective bargaining units. Each of the remaining exclusive representatives represents only one bargaining unit.

The CCPOA filed an arbitration with the DPA in regard to employees' salary and benefits under its existing agreement. A compensation relationship exists between members of California Association of Highway Patrol ("CAHP") and members of CCPOA. The CCPOA argued that benefits provided to members of CAHP beginning July 1, 2005 were not also provided to CCPOA members. The CCPOA prevailed in the arbitration. A final award was signed on January 18, 2007.

The table below presents the costs of the final award.

Fiscal Year	Final Award
2005-06	$132,447,000
2006-07	$147,473,000
2007-08	$159,840,000
Totals	**$439,760,000**

Source: State of California, Department of Finance.

The arbiter's final award provides for $200 million for all costs through December 31, 2006. Of this amount, $132.4 million is for costs associated with 2005-06. The cost of the arbiter's final award in 2006-07 is $147.5 million, of which $67.6 million is for costs from July 2006 through December 2006, and is included in the $200 million. An additional $79.9 million is the cost of the award for January 2007 through June 2007. The ongoing cost of the award will be $159.8 million.

On May 10, 2007, the DPA formally requested mediation with the PERB in its year-long negotiations with the CCPOA over a new contract.

The state's four-year offer includes raises estimated to total 18 percent plus an additional 1 percent for pre- and post-shift activities, and increases in health benefits, shift differentials, and uniform allowances. It also doubles recruitment and retention pay for hard-to-recruit facilities and establishes a bonus program for employees who recruit new correctional officers, paying $2,000 for each new recruit. The total cost of the contract offer is approximately $2.15 billion over the four years.

Negotiations have stalled over CCPOA demands for pay increases beyond what the state has offered, as well as the union's refusal to negotiate changes to contract provisions that have become increasingly problematic to prison operations. The provisions the state seeks to modify primarily concern sick leave, the grievance and arbitration process, and the "entire agreement" clause, a provision that obligates management to negotiate with the union before making virtually any operational change.

ECONOMY AND POPULATION

Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. In early 2001, California's economy slipped into a recession, which was concentrated in the state's high-tech sector and, geographically, in the San Francisco Bay Area. The economy has since recovered with 887,100 jobs gained between July 2003 and March 2007 compared with 362,000 jobs lost between January 2001 and July 2003. See "CURRENT STATE BUDGET—Economic Assumptions."

Population and Labor Force

The state's July 1, 2006 population of about 37.4 million represented over 12 percent of the total United States population. California is by far the most populous state in the nation, almost two-thirds larger than the second-ranked state according to the 2000 U.S. Census. California has grown about twice as rapidly as the national population during the last half of the 20th century, averaging about 26% growth for each decade between 1950 and 2000. Although California's growth slowed during the 1990s, and is not expected to match the levels of the earlier decades before 1990, it is still expected to be in the range of 1 to 1.3% annually through at least the end of this decade. Population growth is expected to be about two-thirds due to natural increase (excess of births over deaths) and one-third to net migration into the state.

Population growth in the next five years is expected to be largest in the over age 65 category, with above statewide average growth in the working age and college age categories. The school age category will have lower than statewide average growth, reflecting lower births in the state during the 1990s when the current and near future school age population was born. The preschool population grows at about the same rate as the overall population as births have been on the rise since 2001.

California's population is perhaps the most diverse in the nation. As of the 2000 Census, no single ethnic group constituted a majority of the population. It is estimated that within the next 10-15 years, the Latino population will be the largest ethnic group in the state.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the state. As of July 1, 2006, the 5-county Los Angeles area accounted for 49 percent of the state's population, with over 18.0 million residents, and the 11-county San Francisco Bay Area represented 21 percent, with a population of nearly 8.0 million.

The following table shows California's population data for 1996 through 2006.

TABLE 21

Population 1996-2006[(a)]

Year	California Population	% Increase Over Preceding Year	United States Population	% Increase Over Preceding Year	California as % of United States
1996	31,963,000	0.8	269,394,284	1.2	11.9
1997	32,453,000	1.5	272,646,925	1.2	11.9
1998	32,863,000	1.3	275,854,104	1.2	11.9
1999	33,419,000	1.7	279,040,168	1.2	12.0
2000	34,099,000	2.0	282,216,952	1.1	12.1
2001	34,784,000	2.0	285,226,284	1.1	12.2
2002	35,393,000	1.7	288,125,973	1.0	12.3
2003	35,990,000	1.7	290,796,023	0.9	12.4
2004	36,522,000	1.5	293,638,158	1.0	12.4
2005	36,982,000	1.3	296,507,061	1.0	12.5
2006	37,444,000	1.3	299,398,484	1.0	12.5

(a) Population as of July 1.

Source: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1995 to 2006.

TABLE 22

Labor Force 1995-2006
(Thousands)

Year	Labor Force	Employment	Unemployment Rate (%) California	Unemployment Rate (%) United States
1995	15,264	14,062	7.9%	5.6%
1996	15,436	14,304	7.3	5.4
1997	15,793	14,781	6.4	4.9
1998	16,167	15,204	6.0	4.5
1999	16,431	15,567	5.3	4.2
2000	16,858	16,024	4.9	4.0
2001	17,152	16,220	5.4	4.7
2002	17,344	16,181	6.7	5.8
2003	17,419	16,227	6.8	6.0
2004	17,539	16,445	6.2	5.5
2005	17,740	16,782	5.4	5.1
2006	17,902	17,029	4.9	4.6

Source: State of California, Employment Development Department.

Employment, Income, Construction and Export Growth

The following table shows California's non-agricultural employment distribution and growth for 1996 and 2006.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

TABLE 23

Payroll Employment By Major Sector
1996 and 2006

Industry Sector	Employment (Thousands) 1996	Employment (Thousands) 2006	% Distribution of Employment 1996	% Distribution of Employment 2006
Trade, Transportation and Utilities	2,456.2	2,873.8	19.3%	19.1%
Government				
Federal Government	295.9	247.6	2.3	1.6
State and Local Government	1,817.5	2,199.7	14.3	14.6
Professional and Business Services	1,742.3	2,225.1	13.7	14.8
Educational and Health Services	1,267.5	1,618.3	9.9	10.7
Manufacturing				
Nondurable goods	646.0	544.2	5.1	3.6
High Technology	516.4	393.2	4.1	2.6
Other Durable Goods	620.1	567.1	4.9	3.8
Leisure and Hospitality	1,226.5	1,519.4	9.6	10.1
Financial Activities	737.8	940.7	5.8	6.2
Construction	517.2	939.4	4.1	6.2
Other Services	440.3	506.5	3.5	3.4
Information	433.9	472.8	3.4	3.1
Natural Resources and Mining	25.9	25.1	0.2	0.2
TOTAL NON-AGRICULTURAL	12,743.4	15,072.8	100%	100%

Source: State of California, Employment Development Department.

The following tables show California's total and per capita income patterns for selected years.

TABLE 24

Total Personal Income in California 1995-2006[(a)]

Year	Millions	% Change[(b)]	California % of U.S.
1995	$ 765,806	4.8%	12.4%
1996	810,448	5.8	12.3
1997	860,545	6.2	12.4
1998	936,009	8.8	12.5
1999	999,228	6.8	12.7
2000	1,103,842	10.5	13.0
2001	1,135,304	2.9	12.9
2002	1,147,716	1.1	12.8
2003	1,187,040	3.4	12.9
2004	1,268,049	6.8	13.0
2005	1,335,386	5.3	13.0
2006 [(p)]	1,420,245	6.4	13.0

(a) Bureau of Economic Analysis ("BEA") estimates as of March 27, 2007.
(b) Change from prior year.
(p) Preliminary
Note: Omits income for government employees overseas.
Source: U.S. Department of Commerce, BEA.

TABLE 25

Per Capita Personal Income 1995-2006[a]

Year	California	% Change[b]	United States	% Change[b]	California % of U.S.
1995	$24,161	4.1%	$23,076	4.1%	104.7%
1996	25,312	4.8	24,175	4.8	104.7
1997	26,490	4.7	25,334	4.8	104.6
1998	28,374	7.1	26,883	6.1	105.5
1999	29,828	5.1	27,939	3.9	106.8
2000	32,458	8.8	29,843	6.8	108.8
2001	32,859	1.2	30,562	2.4	107.5
2002	32,769	-0.3	30,795	0.8	106.4
2003	33,469	2.1	31,466	2.2	106.4
2004	35,380	5.7	33,090	5.2	106.9
2005	36,936	4.4	34,471	4.2	107.2
2006 (p)	38,956	5.5	36,276	5.2	107.4

(a) BEA's estimates as of March 27, 2007.
(b) Change from prior year.
(p) Preliminary

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA.

The following tables show California's residential and non-residential construction.

TABLE 26

Residential Construction Authorized by Permits

Year	Units			Valuation[a]
	Total	Single	Multiple	(millions)
1995	85,293	68,689	16,604	$13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	140,137	101,711	38,426	25,783
2000	148,540	105,595	42,945	28,142
2001	148,757	106,902	41,855	28,804
2002	167,761	123,865	43,896	33,305
2003	195,682	138,762	56,920	38,968
2004	212,960	151,417	61,543	44,777
2005	208,972	155,322	53,650	47,138
2006 /p	164,044	107,470	56,574	38,123

p/ Preliminary

(a) Valuation includes additions and alterations.

Source: Construction Industry Research Board

TABLE 27

Nonresidential Construction (Thousands)

Year	Commercial	Industrial	Other	Additions and Alterations	Total
1995	$2,308,911	$ 732,874	$1,050,693	$4,062,273	$ 8,154,751
1996	2,751,925	1,140,574	1,152,443	4,539,219	9,584,161
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,706,719	2,256,166	2,350,213	6,269,194	16,582,292
2000	6,962,031	2,206,169	2,204,754	7,252,004	18,624,958
2001	6,195,368	1,552,047	2,584,321	6,421,551	16,753,287
2002	5,195,348	1,227,754	2,712,681	5,393,329	14,529,112
2003	4,039,561	1,320,222	2,954,039	5,601,117	13,914,939
2004	5,105,541	1,456,283	3,100,982	6,026,567	15,689,373
2005	5,853,351	1,693,373	3,818,100	6,900,709	18,265,533
2006 p/	7,730,542	1,760,888	3,869,840	7,740,061	21,101,331

p/ Preliminary

Source: Construction Industry Research Board

The following table shows changes in California's exports for the period from 1996 through 2006.

TABLE 28

Exports Through California Ports (Millions)

Year	Exports[(a)]	% Change[(b)]
1995	$116,825.0	22.2%
1996	124,120.0	6.2
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999	122,092.8	5.0
2000	148,554.6	21.7
2001	127,255.3	-14.3
2002	111,340.1	-12.5
2003	113,550.7	2.0
2004	123,039.2	8.4
2005	129,988.9	5.6
2006	147,823.8	13.7

(a) "Free along ship" Value Basis.

(b) Change from prior year.

Source: U.S. Department of Commerce, Bureau of the Census

LITIGATION

The state is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "LITIGATION" in the main body of the Official Statement.

Challenge Seeking Payment to Teachers' Retirement Board

In May 2003, the Legislature enacted legislation (Chapter 6, Statutes of 2003–04, First Extraordinary Session, Senate Bill No. 20, "SBX1 20") that deferred the payment of $500 million to CalSTRS's Supplemental Benefit Maintenance Account ("SBMA"). SBX1 20 also establishes an appropriation of an amount not to exceed $500 million, adjusted by the actual rate of return to funds in the SBMA, in 2006 and every four years thereafter, for the purpose of funding the SBMA. The actual amount of such appropriation, if any, will be determined following a report by the CalSTRS managing board that the funds in the SBMA will be insufficient in any fiscal year before July 1, 2036, to provide certain payments to CalSTRS members, and the certification of the amount of any such appropriation by the state's Director of Finance. On October 14, 2003, the CalSTRS board and certain CalSTRS members filed a complaint in the Sacramento County Superior Court as *Teachers' Retirement Board, as Manager of the California State Teachers' Retirement System, et al. v. Tom Campbell, Director of California Department of Finance, and Steve Westly, California State Controller* (Case No. 03CS01503). This lawsuit seeks, primarily, to compel the State Controller to transfer funds from the state's General Fund to the SBMA in an amount equal to the continuing appropriation, as it existed prior to the enactment of SBX1 20 ($500 million plus interest). The trial court granted plaintiffs' motion for summary adjudication. The court declared SBX1 20 unconstitutionally impairs CalSTRS members' vested contractual rights. The court ordered the State Controller to transfer $500 million from the General Fund to the SBMA. The state has appealed the decision, and plaintiffs and the intervening California Retired Teachers' Association have filed cross-appeals (Court of Appeal, Third Appellate District, Case No. C050889). Briefing is complete; no date has been set for argument.

Action Seeking Modification of Retirement Formula for State Employees

A case entitled *Joseph Myers et al. v. CalPERS et al.* (Alameda County Superior Court, Case No. RG06-262495), plead as a class action on behalf of state employees over age 55 who will retire after January 1, 2001, asserts that Government Code section 21354.1 "discriminates" against older workers in violation of the California Fair Employment and Housing Act because the statute changes the retirement formulas to give them a smaller percentage increase in benefits than it provided to younger workers. The complaint seeks injunctive relief and retroactive retirement benefits of an unspecified nature. Because it is unclear from the complaint what retroactive retirement benefits are being sought, or whether they would be offset by reductions in benefits to younger workers, it is impossible at this time to quantify the magnitude of the fiscal impact; however, it may be in excess of $250 million. The state's second demurrer to the entire complaint was sustained without leave to amend. Plaintiffs filed an appeal on March 16, 2007 (Court of Appeal, First Appellate District, Case No. A117206).

Tax Refund Cases

Six cases have been filed challenging the Franchise Tax Board's treatment of proceeds from the investment of cash in short-term financial instruments, and the resulting impact on the apportionment of corporate income to a corporation's California tax obligation. These cases are: *General Motors Corp. v. Franchise Tax Board* (Court of Appeal, Second Appellate District, Case No. B165665); *Microsoft Corporation v. Franchise Tax Board* (2006) 39 Cal.4th 750; *The Limited Stores, Inc. and Affiliates v. Franchise Tax Board* (Court of Appeal, First Appellate District, Case No. A102915); *Toys "R" Us, Inc.*

v. Franchise Tax Board (Court of Appeal, Third Appellate District, Case No. C045386); *Montgomery Ward LLC v. Franchise Tax Board* (San Diego County Superior Court, Case No. 802767); and *Colgate-Palmolive v. Franchise Tax Board* (Sacramento County Superior Court, Case No. 03AS00707). The California Supreme Court granted review in *General Motors*, *Microsoft*, *The Limited* and *Toys "R" Us*. On August 17, 2006, the California Supreme Court issued its decisions in *Microsoft* and *General Motors*. In *Microsoft*, the Court affirmed the judgment in favor of the Franchise Tax Board. The Court concluded that while returned principal from investments in short-term financial instruments is a "receipt" for income apportionment purposes, the inclusion of returned principal in the income calculation results in an apportionment percentage that does not fairly reflect Microsoft's business activities in California. The Court therefore upheld Franchise Tax Board's use of an alternative apportionment method under Revenue and Taxation Code section 25137 that excluded returned principal from the calculation. In *General Motors*, as in *Microsoft*, the Court held that returned principal was a receipt, but also held that only the interest portion of proceeds from loans generally, and from repurchase transactions specifically, could be included in the income apportionment calculation. The Court remanded the *General Motors* case for a determination of the proper treatment of other treasury function investments entered into by the taxpayer in light of its decision in this case and in the *Microsoft* case. On January 29, 2007, the Court of Appeal remanded the *General Motors* case for further proceedings.

After the *Microsoft* and *General Motors* decisions, the California Supreme Court ordered the *Limited Stores* case to be transferred to the Court of Appeal, First Appellate District, and the *Toys "R" Us* case to be transferred to the Court of Appeal, Third Appellate District, with directions in each case to vacate the prior decision and to reconsider the case in the light of the *Microsoft* and *General Motors* decisions. Both cases are pending in the appellate courts. In *The Limited* case, the Court of Appeal has permitted additional briefing. *Montgomery Ward* and *Colgate-Palmolive* are pending in the trial courts. Until further guidance is provided by the courts, it is impossible to determine the extent of any fiscal impact upon state revenues.

Three pending cases challenge the fee imposed by Revenue and Taxation Code section 17942 upon limited liability companies registered in California, alleging that it discriminates against interstate commerce and violates the Due Process and Equal Protection clauses of the federal Constitution. In the alternative, the plaintiffs also allege that the Franchise Tax Board misinterprets section 17942 and that section 17942 is an improper exercise of the state's police powers. These cases are: *Northwest Energetic Services, LLC v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-05-437721; Court of Appeal, First Appellate District, Case No. A115950); *Ventas Finance I, LLC v. Franchise Tax Board* (San Francisco County Superior Court, Case No. 05-440001; Court of Appeal, First Appellate District, Case No. A116277); and *Bakersfield Mall LLC v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC07462728). In *Northwest* and *Ventas*, the trial court has ruled in favor of the plaintiffs, and these matters are currently on appeal. *Bakersfield Mall* was filed on April 25, 2007, as a class action on behalf of all LLCs operating in California; if it proceeds as a class action the claimed refunds would be significant. See "STATE FINANCES – Sources of Tax Revenue - Corporation Tax."

Five cases have been filed challenging the constitutionality of the state's tax amnesty program: *General Electric Company & Subsidiaries v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 06-449157; Court of Appeal, First Appellate District, Case No. A115530); *Garcia v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 06-456659); *Hargis v. Franchise Tax Board* (San Diego County Superior Court, Case No. GIC 876431); *Duffield v. Franchise Tax Board* (San Francisco County Superior Court, Case No. 459331); and *Gonzales v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 06-454297). Chapter 226, Statutes of 2004 ("SB 1100") created an amnesty program for taxable years beginning before January 1, 2003. Under the program, taxpayers that had not paid or had underpaid an eligible tax could agree to pay the tax and waive their rights to claim refunds thereof. In exchange, certain penalties and fees associated with the unpaid taxes would be waived and no criminal actions would be brought for the taxable years for which amnesty was allowed. SB 1100 also imposed a new penalty equal to 50 percent of accrued interest as of March 31, 2005 on any unpaid tax liabilities ultimately determined to be due for taxable years 2002 and earlier for which amnesty could have been requested. In *General Electric*, no penalty has been assessed because the companies' final tax liability for the years has not been determined. General Electric seeks a declaration that the amnesty penalty should not apply to tax liabilities that become final after the amnesty period and that are paid within the statutory payment period, or alternatively, that the amnesty penalty is unconstitutional because it violates due process. On September 15, 2006, General Electric appealed the trial court's decision sustaining of the Franchise Tax Board's demurrer to the complaint without leave to amend. The other cases are pending in the trial court; the *Garcia* case is set for trial in August 2007. The fiscal impact of these cases is unknown at this time and is dependent on court rulings, but is estimated to be in excess of $300 million.

In *Bratton v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 07-461671), the plaintiff is challenging a penalty assessed for promotion of an abusive tax shelter. The amount in dispute is $600,000, but an adverse ruling in this matter, applied to other similarly situated plaintiffs, could have a more significant fiscal impact.

Nortel v. State Board of Equalization (Los Angeles County Superior Court, Case No. BC341568), a tax refund case, involves the interpretation of certain statutory sales and use tax exemptions for "custom-written" computer software and licenses to use computer software. A ruling adverse to the State Board of Equalization in this matter if applied to other similarly situated taxpayers could have a significant negative impact, in the range of approximately $500 million annually, on tax revenues. Trial is currently set for July 23, 2007.

In *Abbott Laboratories v. Franchise Tax Board* (Los Angeles County Superior Court, Case No. BC369808), the plaintiff is challenging the denial of a deduction for dividends under section 24402 of the Revenue and Taxation Code. Section 24402 was held to be unconstitutional in *Farmer Bros. Co. v. Franchise Tax Board* (2003) 108 Cal App 4th 976, because it allowed a dividend deduction only to the extent the dividends were paid from income previously taxed by California. After this ruling, the Franchise Tax Board allowed a deduction for all dividends for years in which the normal 4-year statute of limitations prevented additional assessments and denied a deduction for all dividends for all taxpayers for all years in which the 4-year statute was still open. A denial of deductions is the remedy authorized by section 19393 of the Revenue and Taxation Code. Plaintiff asserts that the proper remedy is to allow a deduction for all dividends based upon either a judicial reformation of the statute on constitutional grounds. An adverse ruling in this matter, applied in the context of other statutes, could have a significant revenue impact.

Environmental Matters

In a federal Environmental Protection Agency ("U.S. EPA") administrative abatement action entitled *In the Matter of: Leviathan Mine, Alpine County, California, Regional Water Quality Control Board, Lahontan Region, State of California* (U.S. EPA Region IX CERCLA Docket No. 00-16(a)), the state, as owner of the Leviathan Mine, is a party through the Lahontan Regional Water Quality Control Board. Also a party is ARCO, the successor in interest to the mining company that caused certain pollution of the mine site. The Leviathan Mine site is listed on the U.S. EPA "Superfund" List, and both remediation costs and costs for Natural Resource Damages may be imposed on the state. The alleged bases for the state's liability are the state's ownership of the mine site and the terms of a 1983 settlement agreement with ARCO. The Lahontan Regional Water Quality Control Board has undertaken certain remedial action at the mine site, but the U.S. EPA's decision on the interim and final remedies is pending. ARCO has filed several state law claims against the state with the California Victim Compensation and

Government Claims Board (an administrative agency with which certain claims must be filed as a prerequisite to litigation seeking damages against the state which was formerly named the Board of Control). Litigation on these claims has been tolled by agreement among the parties until January 1, 2008. It is possible these matters could result in a potential loss to the state in excess of $400 million.

In *Carla Clark, et. al. v. City of Santa Rosa, et al.* (Sonoma County Superior Court, Case No. SCV-227896), 32 plaintiffs who own property or live in Santa Rosa brought a toxic tort case alleging that water wells supplying water to their homes were contaminated by carcinogenic chemicals. The state is sued under a mandatory duty theory premised on an alleged violation of Proposition 65 (The Safe Drinking Water and Toxic Enforcement Act of 1986). Plaintiffs claim property damage, a variety of physical and psychological maladies including birth defects, medical monitoring costs and damages for fear of cancer. Plaintiffs claim damages exceeding $400 million. After a jury trial ended in a mistrial, the court reconsidered and granted the state's motion for summary judgment. Plaintiffs have appealed (Court of Appeal, First Appellate District, Case No. A115399).

Energy-Related Matters

In *People v. ACN Energy, Inc., et al.* (Sacramento County Superior Court, Case No. 01AS05497), participants in the California Power Exchange market claimed compensation as a result of the Governor's issuance of executive orders, under the California Emergency Service Act, "commandeering" power purchase arrangements held by Pacific Gas & Electric Company ("PG&E") and Southern California Edison ("SCE"), referred to as "block forward contracts." The California Power Exchange, PG&E and all but one of the other market participants have dismissed their actions, which were pending in Sacramento County Superior Court (Judicial Council Coordination Proceeding No. 4203). The only remaining action is that of the Los Angeles Department of Water and Power (LADWP), which asserts damages in the amount of $110 million. The state disputes that LADWP was damaged in any amount.

Escheated Property Claims

In three pending cases, plaintiffs claim that the State Controller has an obligation to pay interest on private property that has escheated to the state, and that failure to do so constitutes an unconstitutional taking of private property: *Morris v. Westly* (Los Angeles County Superior Court, Case No. BC310200); *Trust Realty Partners v. Westly* (Sacramento County Superior Court, Case No. 04AS02522); and *Coppoletta v. Westly* (Sacramento County Superior Court, Case No. CGC- 05439933). The *Morris* lawsuit challenges whether the state's custodial use of escheated funds entitles the claimant to constructive interest and/or actual interest that was earned while the property is in the state's custody. The *Morris* case seeks a class action determination, and identifies a purported class that could be interpreted to include all persons or entities whose property has been taken into custody by the state. On behalf of the articulated class, the plaintiff in *Morris* seeks a declaration that failure to pay interest is an unconstitutional taking and, among other things, an injunction restraining the State Controller from pursuing the complained-of practices. The trial court in *Morris* ordered judgment be entered in favor of the state. Plaintiff has filed a notice of appeal (Court of Appeal, Second Appellate District, Case No. B194764). The *Trust Realty Partners* lawsuit focuses on the state's elimination of interest payments on unclaimed property claims (Code of Civil Procedure section 1540, subdivision (c), as amended effective August 11, 2003, "CCP 1540"). The *Trust Realty Partners* case is not styled as a class action suit, but in addition to seeking general and special damages, the case seeks a common fund recovery and an injunction restraining the State Controller from engaging in the acts alleged. In May 2006, the trial court granted an interim order on a motion for summary adjudication ordering the state to pay interest on certain pending claims made before the amendment to CCP 1540. The Controller filed an appeal of this order; briefing is completed and no date has been set for oral argument (Court of Appeal, Third Appellate District, Case No. C052813). The *Coppoletta* case raises issues analogous to those in *Morris* and also asks that the unclaimed property law be construed as creating a trust for the benefit of the true owner. The trial court dismissed the case in *Coppoletta,* and plaintiffs have filed an appeal (Court of Appeal, First Appellate District, Case No. A117504). If the *Morris* case ultimately prevails as a class action, or the injunctions prayed for in the *Trust Realty Partners* cases are upheld on appeal, or if the issues raised in any of these cases require the State Controller to pay interest on escheated property or to manage unclaimed property as a trust for the benefit of the true owners, as the plaintiffs allege is required by law, costs to the state could be in excess of $500 million.

In *Taylor v. Chiang* (U.S. District Court, Eastern District, No. S-01-2407 WBS GGH), plaintiffs challenge the constitutional adequacy of the notice provided by the state to owners of unclaimed property before the state takes possession of and sells such property. On June 1, 2007, the trial court issued a preliminary injunction prohibiting the State Controller from taking possession of, selling or destroying property pursuant to the state's unclaimed property law until the state enacts and the court approves new notice provisions. A bill amending the state's current notice procedures is currently pending in the Legislature. The preliminary injunction, while it is in effect, will prevent the transfer of unclaimed cash and other property to the state's General Fund. In Fiscal Year 2006-07, the State accounted for net receipts from this source in the amount of $392 million.

Actions Seeking Damages for Alleged Violations of Privacy Rights

In *Gail Marie Harrington-Wisely, et al. v. State of California, et al.* (Los Angeles County Superior Court, Case No. BC 227373), a proposed class action, plaintiffs seek damages for alleged violations of prison visitors' rights resulting from the Department of Corrections and Rehabilitation's use of a body imaging machine to search visitors entering state prisons for contraband. This matter has been certified as a class action. The trial court granted final judgment in favor of the state. Plaintiffs have appealed (Court of Appeal, Second Appellate District, Case No. B190431). If a court were to revive the damages claims and award damages pursuant to the California Civil Code for every use of the body-imaging machine, damages could be as high as $3 billion.

Gomez v. Saenz, et. al. (Los Angeles County Superior Court, Case No. BC 284896) involves due process constitutional challenges to an individual being placed on the state's child abuse central index prior to the conclusion of a noticed hearing. In another case, a California appellate court held that a hearing is required before an individual is placed on the child abuse central index. However, the appellate court did not decide the issue of what type of hearing would be sufficient. That issue is the subject of the current activity at the trial court in *Gomez*. Depending on the type and scope of the hearing that the trial court might order, and the number of individuals currently on the index that might be entitled to a hearing prior to remaining on the index, the costs to the state related to conducting these hearings could be in excess of $500 million.

The plaintiff in *Gilbert P. Hyatt v. FTB* (State of Nevada, Clark County District Court, Case No. A382999) was subject to an audit by the Franchise Tax Board involving a claimed change of residence from California to Nevada. Plaintiff filed a tort action in the State of Nevada alleging a number of separate torts involving privacy rights and interference with his business relationships arising from the audit. A Nevada jury trial was scheduled, but the trial judge ordered a stay of the trial pending the Nevada Supreme Court's consideration on a writ filed by plaintiff asking for review of the trial court's ruling that he had not established a causal relation between the audit and the loss of his licensing business with Japanese companies. The economic damages claim exceeded $500 million. The Nevada Supreme Court denied the request for a writ on May 11, 2007, and it is expected that this matter will be scheduled for a trial date in late 2007 or early 2008. The state is vigorously contesting this matter.

Action Seeking a Cost of Living Adjustment for CalWORKs Recipients

In *Juana Raquel Guillen, et al. v. Schwarzenegger, et al.* (Court of Appeal, First Appellate District, Case No. A106873), the trial court determined that Governor Schwarzenegger's executive order in November 2003, which reduced the Vehicle License Fee charged to vehicle owners and increased the corresponding Vehicle License Fee offset to local governments (See "STATE FINANCES—Local Governments—Vehicle License Fee"), acted as an "increase in tax relief", which, by statute, triggers an upward cost of living adjustment for recipients of CalWORKs program benefits. The petitioners seek a cost of living adjustment, beginning with fiscal year 2003–04. The Court of Appeal, on February 16, 2007, reversed the trial court judgment against the state; petitioners filed a petition seeking review by the California Supreme Court on March 28, 2007; the Court has not yet ruled on the petition. The cost to the state of a final, unappealable determination consistent with the determination of the trial court, is estimated to be in excess of $550 million for the 2007-08 fiscal year.

Action Seeking Program Modifications

In the following case, plaintiffs seek a court order or judgment that would require the state to modify existing programs and, except as specified, do not seek monetary damages. Nevertheless, a judgment against the state could require changes in the challenged program that could result in increased programmatic costs to the state in a future fiscal year in excess of $250 million. Alternatively, it may be possible that a judgment against the state could be addressed by legislative changes to the program that would cost less.

In *Capitol People First v. Department of Developmental Services* (Alameda County Superior Court, Case No. 2002-038715) a consortium of state and national law firms and public-interest groups brought suit against the Department of Finance, Department of Developmental Services and Department of Health Services, alleging violations of the Lanterman Act, the Americans with Disabilities Act, and section 504 of the Rehabilitation Act resulting in needlessly isolating thousands of people with developmental disabilities in large facilities. The case seeks sweeping reforms to state programs for the treatment of institutionalized disabled persons, including requiring the state to offer a full range of community-based services. Some rough estimates suggest the financial impact of a judgment against the state defendants could be as high as $1 billion per year in programmatic costs going forward. The state is vigorously defending this action.

Actions Seeking Medi-Cal Reimbursements

Two cases, each entitled *California Association of Health Facilities ("CAHF") v. Department of Health Services ("DHS")*, have been consolidated in the Court of Appeal (First Appellate District, Case Nos. A107551 and A107552). CAHF, which represents approximately 1400 skilled-nursing and intermediate-care facilities, filed two separate cases challenging the Medi-Cal reimbursement rates paid by DHS to providers for, respectively, the 2001-02 and 2002-03 rate years. The trial court sustained DHS's demurrers in both cases and entered judgment for DHS. On December 26, 2006, the Court of Appeal reversed and remanded the case to the trial court for further proceedings. A final decision adverse to DHS in both of the consolidated cases could result in reimbursement costs exceeding $250 million.

Actions to Increase Amount of State Aid for Foster or Adopted Developmentally Disabled Dependent Children

Ten pending class action lawsuits challenge the amount of aid provided by the state for the care of dependent children (either in foster care or adopted) who are developmentally disabled. These cases have been coordinated in *Butler v. Department of Social Services* (Los Angeles County Superior Court, Case No. BC329695). Specifically, plaintiffs assert that they were entitled to, but did not receive, the Alternative Residential Model (ARM) rate (also known as dual agency rate) but have instead been receiving the standard AFDC-FC (foster care) rate and/or the AAP (adoption assistance program) rate. A final decision in favor of these plaintiffs could exceed $450 million. The state is vigorously litigating this issue.

In a statewide class action against the Department of Health Services and Department of Social Services (*Katie A., et al. v. Bonta, et al.,* U.S. District Court, Case No. CV 02-05662 AHM (SHx)), plaintiffs seek to expand Medicaid-covered services under the Early and Periodic Screening, Diagnosis and Treatment program for mentally disordered children in foster care to include what plaintiffs refer to as "wraparound services," "therapeutic foster care," and "comprehensive case management services in a home-like setting." Plaintiffs allege that the Americans with Disabilities Act, the Medicaid Act, the Rehabilitation Act, substantive due process, and Government Code section 11135 require these services. The district court issued a preliminary injunction against the state defendants and ordered the state defendants to provide "wraparound services" and "therapeutic foster care" to class members. Further, the court ordered the state defendants and plaintiffs to meet and confer both to develop a plan to implement the preliminary injunction and to come to consensus on whether the court should appoint a special master. An appeal was filed in the U.S. Court of Appeals, Ninth Circuit (Case No. 06-55559). On March 23, 2007, the Ninth Circuit reversed the decision of the district court and remanded the matter for further proceedings. At this time, it is unknown what financial impact such an unprecedented decision would have on the state's General Fund.

Local Government Mandate Claims and Actions

In a test claim filed by the County of San Bernardino, now pending before the Commission on State Mandates (the "Commission") (Medically Indigent Adults, 01-TC-26 County of San Bernardino, Claimant, Statutes 1982, Chapters 328 and 1594), the Commission is being asked to determine the costs incurred by the county to provide state-mandated care of medically indigent adults ("MIAs"). The amount demanded in the claim for un-reimbursed costs for fiscal year 2000-01 is just over $9.2 million. The County of San Bernardino's test claim poses a potential for a negative impact on the General Fund in the amount of the un-reimbursed costs for all similarly situated county claimants for a period of years, as determined by the Commission. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed $4 billion. How much of that will be determined to be "un-reimbursed" to the counties by the state is unknown. In recent years, the counties have received approximately $1 billion annually in vehicle license fee revenue and $410 million annually in sales tax revenue to fund various public health programs, which include the programs that provide services to MIAs. The County of San Bernardino has requested to withdraw the test claim, and the Commission dismissed the claim on May 31, 2007.

Two lawsuits are pending in which Orange and San Diego counties claim they are entitled to full and immediate reimbursement of all mandated costs for which the state has not provided full reimbursement. These lawsuits were consolidated in San Diego County Superior Court *(County of San Diego v. State of California, et al.,* Case No. GIC 825109, and *County of Orange v. State of California, et al.,* Case No. GIC 827845). These plaintiff counties are seeking relief that would divert current budget appropriations away from various state agencies, and to the counties, as full payment for the un-reimbursed costs of implementing a variety of state mandated programs over the last ten years. The County of San Diego has alleged un-reimbursed costs in excess of $40 million through fiscal year 2003–04 for a variety of programs. The County of Orange has alleged in excess of $116 million for un-reimbursed state-mandated costs. The effects of a final determination by an appellate court that the state is required to reimburse the counties now in an amount equal to the previously unreimbursed state mandated costs, if applied to each of California's 58 counties, could result in costs in excess of $1.5

billion for existing un-reimbursed mandates. Following a trial, the court entered a declaratory judgment in favor of the counties regarding the amounts owed, and issued a writ of mandate commanding the state to comply with Government Code section 17617 by making equal annual payments to the counties over the 15-year term currently prescribed by statute, or a shorter period should the statute be amended. Final judgment has been entered. The state defendants have appealed, and the counties have cross-appealed (Court of Appeal, Fourth Appellate District, Case No. D048743).

In January 1987, the Commission determined that a new statutory requirement for completion of a second science course for graduation from high school imposed reimbursable state-mandated costs on school districts. The State Controller reduced claims for teachers' salaries attributed to the additional science course requirement on the ground that districts were presumed to have laid off non-science teachers to offset any increase in science teachers. On appeal by many school districts the Commission upheld the State Controller's position. In early 2005, the Sacramento County Superior Court issued a judgment (which is now final) in consolidated cases, lead by *San Diego Unified School District, et al., v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 03CS01401) and *Woodland Joint Unified School District v. Commission on State Mandates, et al*. (Sacramento County Superior Court, Case No. 05CS01401), finding the Controller's practice was not authorized by law and ordering the Commission to review a re-evaluation of the claims by the Controller. The Commission has determined that the school districts' claims for extra science teachers' salaries must be paid in full. It is possible that these claims would add hundreds of millions of dollars to existing state funding responsibility for K-12 education.

Actions Seeking to Enjoin Implementation of or Cause Amendment to Certain Tribal Gaming Compacts

In June 2004, the state entered into amendments to tribal gaming compacts (the "Amended Compacts") between the state and five Indian Tribes (the "Five Tribes"). Those Amended Compacts are being challenged as described below. An unfavorable decision to the state in the cases described below (or in any future litigation relating to the Amended Compacts) could eliminate future receipts of gaming revenues anticipated to result from the Amended Compacts, and could delay or impair the state's ability to sell a portion of the revenue stream anticipated to be generated by these Amended Compacts. The state anticipates using the proceeds of that sale to repay existing internal borrowings of transportation funds. See "CURRENT STATE BUDGET—2006 Budget Act– Transportation Funding."

In *Rincon Band of Luiseno Mission Indians of the Rincon Reservation v. Schwarzenegger, et al.* (U.S. District Court, Case No. 04 CV 1151 W (WMc)) the plaintiff (the "Rincon Band"), a federally recognized Indian Tribe, alleges, in primary part, that a compact entered into between the Rincon Band and the state in 1999, is part of a statewide regulatory framework that limits gaming devices and licenses on non–Indian lands for the stated goal of promoting tribal economic development. The plaintiff further alleges that the Amended Compacts would materially alter these protections, and as such, would constitute an unconstitutional impairment of the Rincon Band's 1999 compact. The complaint filed by the Rincon Band seeks, among other things, an injunction against the implementation of the Amended Compacts. It also raises other breach of compact claims. The district court denied plaintiff's motion for injunctive relief, and dismissed the complaint on a procedural basis as to the impairment claims and on lack of jurisdiction as to the breach of compact claims. The district court granted plaintiff's request for re-consideration in part, but dismissed all but four claims that the state failed to negotiate a compact amendment with the Rincon Band in good faith. The injunctive relief denied by the court remains subject to appeal. The state filed a motion for certification and entry of a separate judgment with respect to the four claims that the district court ordered dismissed including the impairment of compact claims. The district court granted the state's motion and entered final judgment from which the Rincon Band filed notice of appeal (U.S. Court of Appeals, Ninth Circuit, Case No. 06-055259). On Appeal, the Rincon

Band abandoned its claims for relief challenging the validity of the Amended Compacts. However, the appeal involves the total number of gaming device licenses authorized under the 1999 compacts. In July 2006, the state filed its answering brief, explaining that resolution of the license issue could adversely affect the tribes with the Amended Compacts. Also, in July 2006, the Five Tribes filed an amicus brief asserting that they were necessary and indispensable parties whose ability to carry out their obligations under the Amended Compacts could be affected. On August 14, 2006, the Rincon Band filed its reply brief.

California Commerce Casino, Inc., et al. v. Schwarzenegger, et al. (Los Angeles County Superior Court, Case No. BS097163) is an action brought by the owner of a card room and an individual plaintiff and petitioner, challenging the Legislature's ratification of the Amended Compacts, which was done through urgency legislation (Statutes 2004, Chapter 91; "Chapter 91"). Plaintiffs and petitioners allege that Chapter 91 violates a provision of the California Constitution, which bars the grant of vested rights or franchises in an urgency measure, and allege a variety of special privileges and vested rights and interests purportedly created by Chapter 91. The complaint also alleges that Chapter 91 violates provisions of the California Constitution which prohibit certain borrowings to fund a year - end state budget deficit; and constitutes an unconstitutional attempt to contract away the state's police power. Plaintiffs and petitioners seek an injunction restraining the implementation of Chapter 91, a decision prohibiting the implementation of Chapter 91, and a declaration that Chapter 91 is unconstitutional. Defendants filed a demurrer to the complaint, which was granted, without leave to amend, on October 25, 2005. In granting the demurrer, the court found that: (1) all nine claims were barred by the 60 day statute of limitations in Chapter 91 and (2) the plaintiffs failed and, because of sovereign immunity, were not able to name the five affected tribes as necessary and indispensable parties. The court dismissed the case with prejudice; and plaintiffs have appealed this decision (Court of Appeal, Second Appellate District, Case No. B188220). The Court of Appeal decision, issued on January 23, 2007, affirmed the trial court decision and dismissed the appeal as untimely. On March 2, 2007, plaintiff filed a petition seeking review by the California Supreme Court (Supreme Court Case No. S150681). On May 9, 2007, the California Supreme Court denied the petition for review.

Hollywood Park Land Co., et al. v. Golden State Transportation, et al. (Sacramento Superior Court, Case No. 06AS00166) is a reverse validation action brought by various horse racetrack interests, challenging validity of the proposed issuance of tribal gaming bonds. The plaintiffs' legal theories and complaint are virtually identical to the legal theories and complaint in *California Commerce Casino, Inc., et al. v. Schwarzenegger, et al.* described in the paragraph above *("Commerce Casino").* Specifically, this case claims that the bonds and bond documents would (1) result in unconstitutional contracting away of the state's police power to regulate gaming; and (2) trigger an unconstitutional grant of a franchise, special privilege and/or vested right contained in the Amended Compacts. In addition, plaintiffs allege Chapter 91, and the use of bond proceeds as described therein, would violate the California constitutional prohibition on certain borrowings to fund a year-end state budget deficit. Plaintiffs have sought injunctive relief. The *Commerce Casino* plaintiffs filed a notice of appearance in this case contesting the validity of the bonds and bond documents. In addition, the Gabrielino-Tongva Tribe and a tribal councilman filed a notice of appearance and written response contesting the validity of the bonds and the bond contracts. Additionally, they seek to have the tribal-state exclusivity provisions of the Amended Compacts declared invalid and void and a declaration that CCP section 1811 is unconstitutional as violating the due process rights of the tribe and its members. On March 14, 2007, the trial court vacated the trial date and stayed this matter pending a decision by the California Supreme Court on the petition for review filed in *Commerce Casino*. Following the California Supreme Court's denial of the petition for review in *Commerce Casino*, both parties in *Hollywood Park* have requested the trial court to lift the stay.

A pending case entitled *San Pasqual Band of Mission Indians v. State of California, et al.* (U.S. District Court, Case No. 06 CV 0988 LAB AJE) asserts that the slot machine licenses that the Five Tribes were required to keep in operation as a condition of being allowed access to additional slot machines are available for issuance through the license draw process provided for in the 1999 compacts. The complaint seeks declaratory relief and an order requiring the licenses of the Five Tribes be redistributed or made available to other tribes. Should relief be granted, and the state be ordered to redistribute the licenses, the authority of the Five Tribes to continue to operate the slot machines currently covered by those licenses would be rendered uncertain under the Amended Compacts, which do not contemplate the Five Tribes losing their licenses to operate those machines. The loss of these licenses would thus present questions about the monetary obligations of the Five Tribes that would presumably be required to be addressed by amendment of the Amended Compacts. In March 2007, the district court granted the state's motion to dismiss the complaint, and plaintiff has appealed (U.S. Court of Appeals, Ninth Circuit, Case No. 07-55536).

Matter Seeking Validation of Pension Obligation Bonds

The Legislature enacted the California Pension Restructuring Bond Act of 2004 (Government Code sections 16940 et seq.), which authorized the Pension Obligation Bond Committee (the "Committee") to issue bonds to fund all or a portion of the state's pension obligation in any two fiscal years. The Committee authorized the issuance of bonds in an amount not to exceed $960 million to pay a portion of the state's pension obligation for fiscal year 2004–05. The Committee seeks court validation of the bonds pursuant to a validation process established by Code of Civil Procedure sections 860 et seq. in *Pension Obligation Bond Committee v. All Persons Interested in the Matter of the Validity of the State of California's Pension Obligation, etc.* (Sacramento County Superior Court, Case No. 04AS04303). The trial court found that the bonds were inconsistent with the debt limit in the California Constitution and therefore invalid. The Committee has appealed (Court of Appeal, Third Appellate District, Case No. C051749). The matter has been fully briefed and scheduled for oral argument on June 25, 2007.

Prison Healthcare Reform

Plata v. Schwarzenegger (U.S. District Court, Case No. C-01-1351 T.E.H.) is a class action regarding all prison medical care in the state. Plaintiffs alleged that the state was not providing constitutionally adequate medical care as required by the Eighth Amendment to the U.S. Constitution. The federal court retained jurisdiction to enforce the terms of a stipulated judgment. The district court appointed a Receiver, who took office in April 2006, to run and operate the approximately $1.3 billion adult health care delivery system (excluding mental health and dental care) of the California Department of Corrections and Rehabilitation ("CDCR"), affecting approximately 32 prisons throughout the state (excluding Pelican Bay State Prison). CDCR continues to work with the Receiver. At this time, it is unknown what financial impact this unprecedented litigation would have on the state's General Fund.

STATE DEBT TABLES

The tables which follow provide information on outstanding state debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for state general obligation and lease-purchase bonds, and authorized and outstanding state revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the state expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the state to pay principal and interest on the bonds from the General Fund.

"Special Revenue Fund bonds" also known as "Economic Recovery Bonds," are "self liquidating" general obligation bonds which are primarily secured by a pledge of a one-quarter cent statewide sales and use tax deposited in the Fiscal Recovery Fund. Debt service payments are made directly from the Fiscal Recovery Fund and not the General Fund. The Special Revenue Fund bonds are also general obligations of the state to which the full faith and credit of the state are pledged to the punctual payment of the principal of and interest thereon.

As of May 24, 2007, the state had $1,315,385,000 of outstanding commercial paper notes.

OUTSTANDING STATE DEBT
FISCAL YEARS 2001-02 THROUGH 2005-06
(Dollars in Thousands Except for Per Capita Information)

	2001-02	2002-03	2003-04	2004-05	2005-06
Outstanding Debt(a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating)...................	$ 22,115,362	$ 26,758,626	$ 33,028,807	$ 34,643,757	$ 37,066,227
Enterprise Fund (Self Liquidating).......................	3,211,310	$ 2,801,775	$ 2,210,800	$ 2,084,505	1,960,105
Special Revenue Fund (Self Liquidating).............	$ 0	$ 0	$ 10,896,080	$ 10,727,305	9,759,490
Total..	$ 25,326,672	$ 29,560,401	$ 46,135,687	$ 47,455,567	$ 48,785,822
Lease-Purchase Debt...	6,341,935	6,704,599	7,288,147	7,841,383	7,785,005
Total Outstanding General Obligation Bonds and Lease-Purchase Debt.......................	$ 31,668,607	$ 36,265,000	$ 53,423,834	$ 55,296,950	$ 56,570,827
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds...	$ 3,905,025	$ 5,150,000	$ 7,816,275	$ 4,914,740	$ 5,516,560
Self Liquidating General Obligation Bonds............	$ 11,325	$ 0	$ 0	$ 221,475	$ 0
Self Liquidating Special Fund Revenue Bonds......	$ 0	$ 0	$ 10,896,080	$ 0	$ 0
Lease-Purchase Debt...	$ 229,105	$ 673,975	$ 1,235,660	$ 907,955	$ 882,775
Debt Service (b)					
Non-Self Liquidating General Obligation Bonds...	$ 2,314,724	$ 1,738,740	$ 1,861,972	$ 3,048,739	$ 3,121,563
Lease-Purchase Debt...	$ 635,844	$ 659,255	$ 689,851	$ 740,976	$ 804,311
General Fund Receipts (c).......................................	$ 66,604,508	$ 78,587,019	$ 79,385,818	$ 87,936,942	$ 94,302,567
Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts..	3.48%	2.21%	2.35%	3.47%	3.31%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts................	0.95%	0.84%	0.87%	0.84%	0.85%
Population (d)..	34,784,000	35,393,000	35,990,000	36,506,000	37,005,000
Non-Self Liquidating General Obligation Bonds Outstanding per Capita...	$ 635.79	$ 756.04	$ 917.72	$ 948.99	$ 1,001.65
Lease-Purchase Debt Outstanding per Capita.........	$ 182.32	$ 189.43	$ 202.50	$ 214.80	$ 210.38
Personal Income (e)...	$1,135,304,000	$1,147,716,000	$1,184,265,000	$1,262,306,000	$ 1,338,181,000
Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income....	1.95%	2.33%	2.79%	2.74%	2.77%
Lease-Purchase Debt Outstanding as Percentage of Personal Income............................	0.56%	0.58%	0.62%	0.62%	0.58%

(a) As of last day of fiscal year. Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Calculated on a cash basis. Debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year. For FY 2002-03 and FY2003-04, General Obligation Bond Debt Service was reduced through a debt restructuring program which included the use of proceeds from current refunding bonds to pay certain bonds maturing in those years.
(c) Calculated on a cash basis. General Fund Receipts includes both revenues and nonrevenues, such as borrowings the proceeds of which are deposited in the General Fund (e.g. tobacco securitization bonds).
(d) As of July 1, the beginning of the fiscal year.
(e) Source: U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.gov/
Annual Totals:"Pre-benchmark" Revisions: Released March 28, 2006. California Department of Finance.

SOURCES: Population: State of California, Department of Finance
Personal Income: State of California, Department of Finance; United States, Department of Commerce, Bureau of Economic Analysis (BEA)
Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.
General Fund Receipts: State of California, Office of the State Controller.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of May 1, 2007

(Thousands)

	Voter Authorization Date	Voter Authorization Amount $	Long Term Bonds Outstanding (a) $	Long Term Bonds Unissued (b) $
GENERAL FUND BONDS (Non-Self Liquidating)				
1988 School Facilities Bond Act	11/08/88	800,000	302,060	2,255
1990 School Facilities Bond Act	06/05/90	800,000	338,430	2,125
1992 School Facilities Bond Act	11/03/92	900,000	482,277	1,909
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	03/05/02	2,600,000	671,595	1,920,495
California Library Construction and Renovation Bond Act of 1988	11/08/88	75,000	36,985	2,595
* California Park and Recreational Facilities Act of 1984	06/05/84	370,000	67,240	1,100
* California Parklands Act of 1980	11/04/80	285,000	12,415	0
California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000	03/07/00	350,000	140,390	196,760
* California Safe Drinking Water Bond Law of 1976	06/08/76	175,000	21,325	2,500
* California Safe Drinking Water Bond Law of 1984	11/06/84	75,000	13,230	0
* California Safe Drinking Water Bond Law of 1986	11/04/86	100,000	46,190	0
California Safe Drinking Water Bond Law of 1988	11/08/88	75,000	41,370	6,960
* California Wildlife, Coastal, and Park Land Conservation Act	06/07/88	776,000	294,950	7,330
Children's Hospital Bond Act of 2004	11/02/04	750,000	119,900	629,545
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (Higher Education)	11/03/98	2,500,000	2,255,055	106,710
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (K-12)	11/03/98	6,700,000	5,838,875	11,860
Clean Air and Transportation Improvement Bond Act of 1990	06/05/90	1,990,000	1,187,215	206,780
* Clean Water Bond Law of 1970	11/03/70	250,000	2,000	0
* Clean Water Bond Law of 1974	06/04/74	250,000	4,575	0
* Clean Water Bond Law of 1984	11/06/84	325,000	45,090	0
* Clean Water and Water Conservation Bond Law of 1978	06/06/78	375,000	13,730	0
Clean Water and Water Reclamation Bond Law of 1988	11/08/88	65,000	39,620	0
* Community Parklands Act of 1986	06/03/86	100,000	23,240	0
* County Correctional Facility Capital Expenditure Bond Act of 1986	06/03/86	495,000	124,705	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/08/88	500,000	230,970	0
* County Jail Capital Expenditure Bond Act of 1981	11/02/82	280,000	15,300	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of May 1, 2007

(Thousands)

	Voter Authorization Date	Voter Authorization Amount $	Long Term Bonds Outstanding (a) $	Long Term Bonds Unissued (b) $
GENERAL FUND BONDS (Non-Self Liquidating)				
* County Jail Capital Expenditure Bond Act of 1984	06/05/84	250,000	8,650	0
Disaster Preparedness and Flood Prevention Bond Act of 2006	11/07/06	4,090,000	0	4,090,000
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	06/05/90	300,000	205,095	28,300
* Fish and Wildlife Habitat Enhancement Act of 1984	06/05/84	85,000	15,665	0
* Hazardous Substance Cleanup Bond Act of 1984	11/06/84	100,000	0	0
* Higher Education Facilities Bond Act of 1986	11/04/86	400,000	53,150	0
Higher Education Facilities Bond Act of 1988	11/08/88	600,000	207,695	10,440
Higher Education Facilities Bond Act of June 1990	06/05/90	450,000	189,055	2,110
Higher Education Facilities Bond Act of June 1992	06/02/92	900,000	546,775	7,235
Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	11/07/06	19,925,000	0	19,925,000
Housing and Emergency Shelter Trust Fund Act of 2002	11/05/02	2,100,000	654,135	1,445,780
Housing and Emergency Shelter Trust Fund Act of 2006	11/07/06	2,850,000	0	2,850,000
Housing and Homeless Bond Act of 1990	06/05/90	150,000	5,095	0
Kindergarten-University Public Education Facilities Bond Act of 2002 (Higher Education)	11/05/02	1,650,000	1,007,390	622,635
Kindergarten-University Public Education Facilities Bond Act of 2002 (K-12)	11/05/02	11,400,000	9,397,170	1,855,980
Kindergarten-University Public Education Facilities Bond Act of 2004 (Hi-Ed)	03/02/04	2,300,000	216,205	2,083,400
Kindergarten-University Public Education Facilities Bond Act of 2004 (K-12)	03/02/04	10,000,000	3,667,270	6,305,560
Kindergarten-University Public Education Facilities Bond Act of 2006 (Hi-Ed)	11/07/06	3,087,000	0	3,087,000
Kindergarten-University Public Education Facilities Bond Act of 2006 (K-12)	11/07/06	7,329,000	0	7,329,000
* Lake Tahoe Acquisitions Bond Act	08/02/82	85,000	12,775	0
* New Prison Construction Bond Act of 1981	06/08/82	495,000	0	0
* New Prison Construction Bond Act of 1984	06/05/84	300,000	0	0
* New Prison Construction Bond Act of 1986	11/04/86	500,000	82,570	0
New Prison Construction Bond Act of 1988	11/08/88	817,000	285,760	7,190
New Prison Construction Bond Act of 1990	06/05/90	450,000	168,505	2,355
Passenger Rail and Clean Air Bond Act of 1990	06/05/90	1,000,000	429,100	0
Public Education Facilities Bond Act of 1996 (Higher Education)	03/26/96	975,000	771,480	37,465
Public Education Facilities Bond Act of 1996 (K-12)	03/26/96	2,025,000	1,515,830	12,965
Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act	03/07/00	1,970,000	835,665	1,041,047

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of May 1, 2007

(Thousands)

	Voter Authorization Date	Voter Authorization Amount $	Long Term Bonds Outstanding (a) $	Long Term Bonds Unissued (b) $
GENERAL FUND BONDS (Non-Self Liquidating)				
Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	11/07/06	5,388,000	0	5,388,000
Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000	03/07/00	2,100,000	1,258,985	745,010
Safe, Clean, Reliable Water Supply Act	11/05/96	995,000	677,830	245,475
* School Building and Earthquake Bond Act of 1974	11/05/74	40,000	26,650	0
School Facilities Bond Act of 1988	06/07/88	800,000	250,645	0
School Facilities Bond Act of 1990	11/06/90	800,000	387,050	0
School Facilities Bond Act of 1992	06/02/92	1,900,000	999,825	10,470
Seismic Retrofit Bond Act of 1996	03/26/96	2,000,000	1,576,400	143,560
* Senior Center Bond Act of 1984	11/06/84	50,000	0	0
* State Beach, Park, Recreational and Historical Facilities Bond Act of 1974	06/04/74	250,000	0	0
* State School Building Lease-Purchase Bond Law of 1982	11/02/82	500,000	0	0
* State School Building Lease-Purchase Bond Law of 1984	11/06/84	450,000	30,250	0
* State School Building Lease-Purchase Bond Law of 1986	11/04/86	800,000	130,900	0
* State, Urban, and Coastal Park Bond Act of 1976	11/02/76	280,000	9,360	0
Stem Cell Research and Cures Bond Act of 2004	11/02/04	3,000,000	0	3,000,000
Veterans Homes Bond Act of 2000	03/07/00	50,000	3,080	46,920
Voting Modernization Bond Act of 2002	03/05/02	200,000	28,060	137,370
Water Conservation Bond Law of 1988	11/08/88	60,000	34,825	8,855
* Water Conservation and Water Quality Bond Law of 1986	06/03/86	150,000	56,210	23,215
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	11/05/02	3,440,000	780,910	2,640,845
Total General Fund Bonds		121,797,000	38,894,747	66,232,106

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

As of May 1, 2007

(Thousands)

	Voter Authorization Date	Voter Authorization Amount $	Long Term Bonds Outstanding (a) $	Long Term Bonds Unissued (b) $
ENTERPRISE FUND BONDS (Self Liquidating)				
* California Water Resources Development Bond Act	11/08/60	1,750,000	640,550	167,600
Veterans Bond Act of 1980	06/03/80	750,000	25,000	0
Veterans Bond Act of 1982	11/02/82	450,000	70,000	0
Veterans Bond Act of 1984	11/06/84	650,000	149,015	0
Veterans Bond Act of 1986	06/03/86	850,000	256,720	0
Veterans Bond Act of 1988	06/07/88	510,000	233,885	0
Veterans Bond Act of 1990	11/06/90	400,000	181,295	0
Veterans Bond Act of 1996	11/05/96	400,000	268,865	0
Veterans Bond Act of 2000	11/07/00	500,000	134,690	365,310
Total Enterprise Fund Bonds		6,260,000	1,960,020	532,910
SPECIAL REVENUE FUND BONDS (Self Liquidating)				
* Economic Recovery Bond Act	04/10/04	15,000,000	8,988,960	3,746,000
Total Special Revenue Fund Bonds		15,000,000	8,988,960	3,746,000
TOTAL GENERAL OBLIGATION BONDS		143,057,000	49,843,727	70,511,016

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) A portion of unissued bonds may be issued initially in the form of commercial paper notes, as authorized from time to time by the respective Finance Committees. A total of not more than $1.5 billion of commercial paper principal and interest may be owing at one time. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS -- Capital Facilities Financing -- Commercial Paper Program" above. Bond acts marked with an asterisk (*) are not legally permitted to utilize commercial paper.

SOURCE: State of California, Office of the Treasurer.

GENERAL OBLIGATION AND LEASE REVENUE BONDS
SUMMARY OF DEBT SERVICE REQUIREMENTS
As of May 1, 2007

		Total Debt	
	Interest	**Principal (a)**	**Total**
GENERAL OBLIGATION BONDS			
GENERAL FUND NON-SELF LIQUIDATING			
Fixed Rate	$ 23,652,141,864.31	$ 35,513,747,123.47	$ 59,165,888,987.78
Variable Rate (b)	2,058,982,019.13	3,381,000,000.00	5,439,982,019.13
ENTERPRISE FUND SELF LIQUIDATING			
Fixed Rate	1,112,820,966.49	1,960,020,000.00	3,072,840,966.49
SPECIAL REVENUE FUND SELF LIQUIDATING (c)			
Fixed Rate	1,642,573,644.27	5,629,395,000.00	7,271,968,644.27
Variable Rate (d)	2,115,039,165.11	3,359,565,000.00	5,474,604,165.11
REVENUE BONDS			
GENERAL FUND LEASE REVENUE			
Lease Purchase	3,969,219,876.24	7,766,296,154.18	11,735,516,030.42
General Fund and Lease Revenue Total (e)	**$ 34,550,777,535.55**	**$ 57,610,023,277.65**	**$ 92,160,800,813.20**

(a) Includes scheduled mandatory sinking fund payments.
(b) The estimate of future interest payments is based on rates in effect as of May 1, 2007.
(c) Economic Recovery Bonds.
(d) The estimate of future interest payments is based on rates in effect as of May 1, 2007. $1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.
(e) Estimated interest included.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
Fixed Rate
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt Interest	Current Debt Principal (a)	Current Debt Total	
2007	93,851,424.13	119,335,000.00	213,186,424.13	(b)
2008	1,724,975,192.14	1,611,973,078.31	3,336,948,270.45	
2009	1,670,268,117.50	1,685,095,000.00	3,355,363,117.50	
2010	1,578,815,948.80	1,791,575,000.00	3,370,390,948.80	
2011	1,484,486,522.34	1,791,174,045.16	3,275,660,567.50	
2012	1,383,984,661.19	1,616,870,000.00	3,000,854,661.19	
2013	1,303,945,941.25	1,349,870,000.00	2,653,815,941.25	
2014	1,239,261,278.39	1,261,890,000.00	2,501,151,278.39	
2015	1,178,820,922.50	1,171,305,000.00	2,350,125,922.50	
2016	1,121,856,597.50	974,840,000.00	2,096,696,597.50	
2017	1,073,143,134.38	914,505,000.00	1,987,648,134.38	
2018	1,027,942,526.88	882,690,000.00	1,910,632,526.88	
2019	982,074,961.25	942,575,000.00	1,924,649,961.25	
2020	933,718,054.89	1,063,875,000.00	1,997,593,054.89	
2021	882,572,899.89	1,001,405,000.00	1,883,977,899.89	
2022	832,460,311.14	1,185,675,000.00	2,018,135,311.14	
2023	772,188,713.43	1,244,570,000.00	2,016,758,713.43	
2024	710,640,283.70	1,170,060,000.00	1,880,700,283.70	
2025	651,380,334.34	1,319,610,000.00	1,970,990,334.34	
2026	586,315,871.14	1,270,890,000.00	1,857,205,871.14	
2027	517,060,216.14	1,310,745,000.00	1,827,805,216.14	
2028	453,571,615.62	1,401,995,000.00	1,855,566,615.62	
2029	388,283,568.75	1,343,670,000.00	1,731,953,568.75	
2030	322,686,850.46	1,441,790,000.00	1,764,476,850.46	
2031	253,991,012.81	1,219,215,000.00	1,473,206,012.81	
2032	195,698,291.25	1,231,065,000.00	1,426,763,291.25	
2033	136,611,706.25	1,130,180,000.00	1,266,791,706.25	
2034	81,128,256.25	894,930,000.00	976,058,256.25	
2035	45,759,650.00	532,730,000.00	578,489,650.00	
2036	20,381,000.00	448,045,000.00	468,426,000.00	
2037	4,266,000.00	189,600,000.00	193,866,000.00	
Total	**$23,652,141,864.31**	**$35,513,747,123.47**	**$59,165,888,987.78**	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from June 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
Variable Rate
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt			
	Interest (a)	**Principal (b)**	**Total**	
2007	11,130,643.46	0.00	11,130,643.46	(c)
2008	129,023,663.62	0.00	129,023,663.62	
2009	128,413,994.16	0.00	128,413,994.16	
2010	128,553,662.22	0.00	128,553,662.22	
2011	128,884,217.78	0.00	128,884,217.78	
2012	128,711,384.86	0.00	128,711,384.86	
2013	128,973,321.60	0.00	128,973,321.60	
2014	128,235,693.44	0.00	128,235,693.44	
2015	128,250,276.77	0.00	128,250,276.77	
2016	128,857,482.76	67,455,000.00	196,312,482.76	
2017	124,652,211.41	372,685,000.00	497,337,211.41	
2018	110,560,510.94	476,190,000.00	586,750,510.94	
2019	93,226,589.05	238,680,000.00	331,906,589.05	
2020	83,499,611.63	230,050,000.00	313,549,611.63	
2021	75,079,506.30	183,510,000.00	258,589,506.30	
2022	68,688,457.23	97,060,000.00	165,748,457.23	
2023	64,669,148.82	119,800,000.00	184,469,148.82	
2024	59,825,679.08	296,540,000.00	356,365,679.08	
2025	48,474,558.24	201,180,000.00	249,654,558.24	
2026	40,186,465.52	346,030,000.00	386,216,465.52	
2027	27,844,617.94	74,285,000.00	102,129,617.94	
2028	25,245,096.44	77,260,000.00	102,505,096.44	
2029	22,077,605.73	110,350,000.00	132,427,605.73	
2030	18,035,889.94	114,760,000.00	132,795,889.94	
2031	13,677,001.33	119,350,000.00	133,027,001.33	
2032	9,283,598.60	124,125,000.00	133,408,598.60	
2033	4,599,593.57	129,090,000.00	133,689,593.57	
2034	94,978.49	1,600,000.00	1,694,978.49	
2035	38,290.00	0.00	38,290.00	
2036	38,455.95	0.00	38,455.95	
2037	38,124.05	0.00	38,124.05	
2038	38,290.00	0.00	38,290.00	
2039	38,290.00	0.00	38,290.00	
2040	35,108.20	1,000,000.00	1,035,108.20	
Total	**$2,058,982,019.13**	**$3,381,000,000.00**	**$5,439,982,019.13**	

(a) The estimate of future interest payments is based on rates in effect as of May 1, 2007. The interest rates for the daily, weekly and auction rate bonds range from 3.50 - 4.00%.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from June 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
Fixed Rate
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt Interest	Current Debt Principal (a)	Current Debt Total	
2008	276,067,262.50	393,925,000.00	669,992,262.50	(b)
2009	256,912,012.50	449,920,000.00	706,832,012.50	
2010	234,396,687.50	506,870,000.00	741,266,687.50	
2011	208,777,650.00	549,060,000.00	757,837,650.00	
2012	180,544,622.50	289,375,000.00	469,919,622.50	
2013	158,128,415.00	603,520,000.00	761,648,415.00	
2014	127,216,935.00	606,870,000.00	734,086,935.00	
2015	95,264,431.77	636,645,000.00	731,909,431.77	
2016	61,418,235.00	702,140,000.00	763,558,235.00	
2017	32,768,530.00	451,820,000.00	484,588,530.00	
2018	10,817,612.50	438,250,000.00	449,067,612.50	
2019	47,500.00	0.00	47,500.00	
2020	47,500.00	0.00	47,500.00	
2021	47,500.00	0.00	47,500.00	
2022	47,500.00	0.00	47,500.00	
2023	47,500.00	0.00	47,500.00	
2024	23,750.00	1,000,000.00	1,023,750.00	
Total	**$1,642,573,644.27**	**$5,629,395,000.00**	**$7,271,968,644.27**	

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from June 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
Variable Rate
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt			
	Interest (a)	Principal (b)	Total	
2007	$ 27,854,256.91	$ -	$ 27,854,256.91	(c)
2008	171,183,597.25	-	171,183,597.25	
2009	169,706,127.75	-	169,706,127.75	
2010	170,444,862.50	-	170,444,862.50	
2011	170,444,862.50	-	170,444,862.50	
2012	170,717,900.91	-	170,717,900.91	
2013	171,105,768.55	-	171,105,768.55	
2014	169,977,890.27	-	169,977,890.27	
2015	169,977,890.27	-	169,977,890.27	
2016	170,717,900.91	-	170,717,900.91	
2017	170,171,824.09	297,410,000.00	467,581,824.09	
2018	164,000,902.55	651,985,000.00	815,985,902.55	
2019	125,894,138.38	985,780,000.00	1,111,674,138.38	
2020	62,954,156.89	704,730,000.00	767,684,156.89	
2021	27,888,378.73	487,785,000.00	515,673,378.73	
2022	1,666,040.90	226,625,000.00	228,291,040.90	
2023	307,400.00	-	307,400.00	
2024	25,265.75	5,250,000.00	5,275,265.75	
Total	$ 2,115,039,165.11	$3,359,565,000.00	$5,474,604,165.11	

(a) The estimate of future interest payments is based on rates in effect as of May 1, 2007. The interest rates for the daily and weekly rate bonds range from 3.72-3.98%. $1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from June 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR ENTERPRISE FUND SELF LIQUIDATING BONDS
Fixed Rate
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (a)	Total	
2007	31,212,375.20	5,800,000.00	37,012,375.20	(b)
2008	99,697,431.04	136,430,000.00	236,127,431.04	
2009	89,909,163.75	135,340,000.00	225,249,163.75	
2010	80,636,239.05	118,190,000.00	198,826,239.05	
2011	73,306,517.02	86,480,000.00	159,786,517.02	
2012	68,673,664.75	100,895,000.00	169,568,664.75	
2013	64,639,254.37	79,885,000.00	144,524,254.37	
2014	60,721,926.00	100,015,000.00	160,736,926.00	
2015	55,877,701.25	113,410,000.00	169,287,701.25	
2016	50,141,225.65	121,080,000.00	171,221,225.65	
2017	44,433,843.88	111,890,000.00	156,323,843.88	
2018	39,895,966.49	73,820,000.00	113,715,966.49	
2019	36,135,273.92	85,085,000.00	121,220,273.92	
2020	32,772,409.86	52,590,000.00	85,362,409.86	
2021	30,101,666.25	45,615,000.00	75,716,666.25	
2022	27,758,882.53	41,240,000.00	68,998,882.53	
2023	26,122,577.62	22,480,000.00	48,602,577.62	
2024	24,915,169.88	27,025,000.00	51,940,169.88	
2025	23,405,874.21	34,450,000.00	57,855,874.21	
2026	21,860,623.55	28,905,000.00	50,765,623.55	
2027	20,413,041.15	31,130,000.00	51,543,041.15	
2028	18,895,015.30	31,795,000.00	50,690,015.30	
2029	17,200,385.30	37,535,000.00	54,735,385.30	
2030	15,148,208.69	45,680,000.00	60,828,208.69	
2031	12,956,647.28	43,500,000.00	56,456,647.28	
2032	10,757,190.00	45,955,000.00	56,712,190.00	
2033	8,452,682.50	47,525,000.00	55,977,682.50	
2034	6,742,417.50	22,705,000.00	29,447,417.50	
2035	5,652,080.00	23,310,000.00	28,962,080.00	
2036	4,609,592.50	20,945,000.00	25,554,592.50	
2037	3,563,105.00	23,610,000.00	27,173,105.00	
2038	2,662,880.00	15,300,000.00	17,962,880.00	
2039	1,950,055.00	16,025,000.00	17,975,055.00	
2040	1,195,310.00	16,790,000.00	17,985,310.00	
2041	404,570.00	17,590,000.00	17,994,570.00	

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR ENTERPRISE FUND SELF LIQUIDATING BONDS
Fixed Rate
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (a)	Total
Total	$1,112,820,966.49	$1,960,020,000.00	$3,072,840,966.49

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from June 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of May 1, 2007

Fiscal Year Ending June 30	Current Debt			
	Interest	Principal (a)	Total	
2007	84,541,352.03	61,595,000.00	146,136,352.03	(b)
2008	392,922,653.98	393,786,787.98	786,709,441.96	
2009	378,514,310.44	417,627,732.44	796,142,042.88	
2010	352,769,589.75	408,451,633.76	761,221,223.51	
2011	321,624,497.10	423,835,000.00	745,459,497.10	
2012	300,732,309.59	408,415,000.00	709,147,309.59	
2013	280,259,516.87	419,740,000.00	699,999,516.87	
2014	259,074,752.52	425,495,000.00	684,569,752.52	
2015	237,246,993.83	446,225,000.00	683,471,993.83	
2016	214,630,413.64	432,415,000.00	647,045,413.64	
2017	192,262,985.45	440,595,000.00	632,857,985.45	
2018	169,969,266.56	456,670,000.00	626,639,266.56	
2019	147,203,373.73	420,445,000.00	567,648,373.73	
2020	125,984,363.12	395,740,000.00	521,724,363.12	
2021	107,110,003.50	338,525,000.00	445,635,003.50	
2022	89,814,596.62	314,915,000.00	404,729,596.62	
2023	75,102,540.66	268,975,000.00	344,077,540.66	
2024	62,239,213.25	189,580,000.00	251,819,213.25	
2025	52,669,164.09	199,140,000.00	251,809,164.09	
2026	43,083,167.56	190,940,000.00	234,023,167.56	
2027	33,361,273.75	200,630,000.00	233,991,273.75	
2028	23,207,405.52	195,120,000.00	218,327,405.52	
2029	14,076,101.14	136,875,000.00	150,951,101.14	
2030	7,355,769.89	106,545,000.00	113,900,769.89	
2031	2,654,483.64	51,760,000.00	54,414,483.64	
2032	809,778.01	22,255,000.00	23,064,778.01	
Total	**$3,969,219,876.24**	**$7,766,296,154.18**	**$11,735,516,030.42**	

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from June 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

STATE PUBLIC WORKS BOARD AND
OTHER LEASE-PURCHASE FINANCING
OUTSTANDING ISSUES
May 1, 2007

Name of Issue	Outstanding
GENERAL FUND SUPPORTED ISSUES:	
State Public Works Board	
California Community Colleges	590,605,000
California Department of Corrections *	2,145,428,789
California Youth Authority	14,895,000
Office of Energy Assessments (a)	31,875,000
The Regents of the University of California (b) *	1,804,457,365
Trustees of the California State University	553,700,000
Various State Office Buildings	1,967,285,000
Total State Public Works Board Issues	**$7,108,246,154**
Total Other State Building Lease Purchase Issues (c)	**$658,050,000**
Total General Fund Supported Issues	**$7,766,296,154**
SPECIAL FUND SUPPORTED ISSUES:	
East Bay State Building Authority *	53,019,016
San Bernardino Joint Powers Financing Authority	47,140,000
San Francisco State Building Authority (d)	29,050,000
Total Special Fund Supported Issues	**$129,209,016**
TOTAL	**$7,895,505,170**

* Includes the initial value of capital appreciation bonds rather than the accreted value.
(a) This program is self-liquidating based on energy cost savings.
(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.
(c) Includes $155,795,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.
(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
As of December 31, 2006

Issuing Agency		Outstanding[a][b]
State Programs Financing:		
California Department of Transportation - GARVEE	$	525,460,000
California Infrastructure and Economic Development Bank [c]		382,645,101
California State University		2,023,033,000
Department of Water Resources - Central Valley Project		2,293,200,000
Department of Water Resources - Power Supply Program		10,501,820,000
The Regents of the University of California		5,813,110,000
Housing Financing:		
California Housing Finance Agency		7,468,879,642
Veterans Revenue Debenture		535,740,000
Conduit Financing:		
California Alternative Energy and Advanced Transportation Financing Authority		53,160,000
California Earthquake Authority		315,000,000
California Educational Facilities Authority		3,464,883,895
California Health Facilities Financing Authority		7,262,745,540
California Infrastructure and Economic Development Bank [c]		4,012,999,405
California Pollution Control Financing Authority		3,679,312,735
California Student Loan Authority		35,405,000
TOTAL	**$**	**48,367,394,318**

[a] Totals for California Department of Transportation (GARVEE), California State University, Department of Water Resources and Veterans Revenue Debenture were provided by the State of California, Office of the Treasurer. All other totals were provided by the listed issuing agency.

[b] Does not include the "tobacco settlement revenue bonds" issued by Golden State Tobacco Securitization Corporation.

[c] Does not include $6 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

April 2007

JOHN CHIANG
California State Controller

JOHN CHIANG
California State Controller

May 10, 2007

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached are the Statements of General Fund Cash Receipts and Disbursements for the period July 1, 2006 through April 30, 2007. These statements reflect the State of California's General Fund cash position and compare actual receipts and disbursements for the 2006-07 fiscal year to cash flow estimates prepared by the Department of Finance for the 2007-08 Governor's Budget as well as the 2006-07 Budget Act. These statements are prepared in compliance with Provision 9 of Budget Act item 0840-001-0001, using records compiled by the State Controller.

Attachment A compares actual receipts and disbursements to date for the 2006-07 fiscal year to cash flow estimates published in the 2007-08 Governor's Budget. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the Governor's Budget.

Attachment B compares actual receipts and disbursements to date for the 2006-07 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2006-07 Budget Act. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's website at http://www.sco.ca.gov/ard/state/index.shtml under the category Monthly Statement of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Michael Carter, Chief Operating Officer, at (916) 552-8080.

Sincerely,

Original Signed By:

JOHN CHIANG
California State Controller

300 Capitol Mall, Suite 1850, Sacramento, CA 95814 ♦ P.O. Box 942850, Sacramento, CA 94250
PHONE: (916) 445-2636 ♦ Fax: (916) 445-6379 ♦ Web Address: www.sco.ca.gov

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2007-08 Governor's Budget Estimates
(Amounts in thousands)

	July 1 through April 30				
	2007				2006
	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	Actual Over or (Under) Estimate %	Actual
GENERAL FUND BEGINNING CASH BALANCE	**$ 9,232,801**	**$ 9,232,801**	**$ -**	**-**	**$ 6,436,788**
Add Receipts:					
Revenues	78,162,517	77,907,082	255,435	0.3	76,309,664
Nonrevenues	844,829	763,888	80,941	10.6	820,169
Total Receipts	79,007,346	78,670,970	336,376	0.4	77,129,833
Less Disbursements:					
State Operations	22,370,361	21,962,556	407,805	1.9	18,715,053
Local Assistance	67,292,331	69,750,422	(2,458,091)	(3.5)	61,669,751
Capital Outlay	2,481,931	2,559,747	(77,816)	(3.0)	1,029,875
Nongovernmental	518,293	555,321	(37,028)	(6.7)	(263,524)
Total Disbursements	92,662,916	94,828,046	(2,165,130)	(2.3)	81,151,155
Receipts Over / (Under) Disbursements	(13,655,570)	(16,157,076)	2,501,506	-	(4,021,322)
Net Increase / (Decrease) in Temporary Loans	4,422,769	6,924,275	(2,501,506)	(36.1)	3,000,000
GENERAL FUND ENDING CASH BALANCE	**-**	**-**	**-**	**-**	**5,415,466**
Special Fund for Economic Uncertainties (b)	-	-	-	-	641,228
TOTAL CASH	**$ -**	**$ -**	**$ -**	**-**	**$ 6,056,694**

BORROWABLE RESOURCES					
Available Borrowable Resources	$ 18,171,708	$ 16,915,448	$ 1,256,260	7.4	$ 14,678,571
Outstanding Loans (c)	4,422,769	6,924,275	(2,501,506)	(36.1)	3,000,000
Unused Borrowable Resources	$ 13,748,939	$ 9,991,173	$ 3,757,766	37.6	$ 11,678,571

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) Statement of Estimated Cash Flow for the 2006-07 fiscal year prepared by the Department of Finance for the 2007-08 Governor's Budget. Any projections or estimates are set forth as such and not as representations of fact.
(b) The Special Fund for Economic Uncertainties amount in the actual column does not include amounts in the Budget Stabilization Account.
(c) Outstanding loan balance of $4.4 billion is comprised of $2.9 billion of internal borrowing and $1.5 billion in external borrowing.
(d) Negative balances are the result of repayments received that are greater than disbursements made.
(e) Includes School Facility Aid Program that was previously displayed separately.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of April		July 1 through April 30				
			2007				2006
					Actual Over or (Under) Estimate		
	2007	2006	Actual	Estimate (a)	Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 22,063	$ 22,162	$ 273,059	$ 263,955	$ 9,104	3.4	$ 260,689
Corporation Tax	1,629,502	1,733,002	8,701,592	8,270,159	431,433	5.2	8,405,710
Cigarette Tax	6,632	8,433	94,205	97,947	(3,742)	(3.8)	96,309
Estate, Inheritance, and Gift Tax	3,086	1,454	21,471	9,356	12,115	129.5	122,188
Insurance Companies Tax	468,707	489,971	1,730,937	1,749,988	(19,051)	(1.1)	1,738,321
Personal Income Tax	12,178,910	11,443,382	44,607,458	44,877,527	(270,069)	(0.6)	42,399,387
Retail Sales and Use Taxes	564,250	883,878	20,762,550	20,596,381	166,169	0.8	21,062,645
Pooled Money Investment Interest	38,617	50,082	479,646	498,211	(18,565)	(3.7)	322,170
Not Otherwise Classified	101,664	86,691	1,491,599	1,543,558	(51,959)	(3.4)	1,902,245
Total Revenues	**15,013,431**	**14,719,055**	**78,162,517**	**77,907,082**	**255,435**	**0.3**	**76,309,664**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfers from Other Funds	7,885	9,745	212,427	170,476	41,951	24.6	276,628
Miscellaneous	12,147	12,210	632,402	593,412	38,990	6.6	543,541
Total Nonrevenues	**20,032**	**21,955**	**844,829**	**763,888**	**80,941**	**10.6**	**820,169**
Total Receipts	**$ 15,033,463**	**$ 14,741,010**	**$ 79,007,346**	**$ 78,670,970**	**$ 336,376**	**0.4**	**$ 77,129,833**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of April		July 1 through April 30				2006
			2007				
	2007	2006	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (d)							
Legislative/Judicial/Executive	$ 68,718	$ 105,401	$ 1,241,314	$ 1,236,412	$ 4,902	0.4	$ 1,183,480
State and Consumer Services	29,342	36,957	508,612	525,530	(16,918)	(3.2)	443,189
Business, Transportation and Housing	(27)	(172)	5,414	4,257	1,157	27.2	4,923
Resources	118,741	16,251	1,035,644	936,485	99,159	10.6	687,388
Environmental Protection Agency	4,591	3,702	51,505	39,182	12,323	31.5	46,009
Health and Human Services:							
Health Services	22,444	(560)	228,745	256,183	(27,438)	(10.7)	226,712
Mental Health Hospitals	61,601	45,398	717,475	771,667	(54,192)	(7.0)	627,089
Other Health and Human Services	29,023	42,166	584,242	531,099	53,143	10.0	594,941
Education:							
University of California	343,290	311,640	2,911,796	2,804,874	106,922	3.8	2,800,728
State Universities and Colleges	252,723	227,778	3,002,491	2,702,798	299,693	11.1	2,029,704
Other Education	9,769	7,710	134,042	154,722	(20,680)	(13.4)	131,440
Dept. of Corrections and Rehabilitation	700,300	594,179	7,032,301	7,078,429	(46,128)	(0.7)	5,954,597
General Government	110,531	80,218	1,687,972	1,645,016	42,956	2.6	1,035,140
Public Employees Retirement System	253,504	273,060	285,144	298,669	(13,525)	(4.5)	275,343
Debt Service	338,338	315,568	2,919,656	2,952,423	(32,767)	(1.1)	2,677,179
Interest on Loans	-	5	24,008	24,810	(802)	(3.2)	(2,809)
Total State Operations	**2,342,888**	**2,059,301**	**22,370,361**	**21,962,556**	**407,805**	**1.9**	**18,715,053**
LOCAL ASSISTANCE (d)							
Public Schools - K-12	2,957,216	1,979,774	33,777,981	34,832,947	(1,054,966)	(3.0)	28,794,531
Community Colleges	300,301	233,490	3,777,783	3,745,161	32,622	0.9	2,975,002
Contributions to State Teachers' Retirement System	120,351	117,262	958,573	958,573	-	-	1,081,064
Other Education (e)	231,776	175,764	2,415,825	2,369,705	46,120	1.9	2,560,595
Dept. of Corrections and Rehabilitation	11,317	56,680	227,020	196,168	30,852	15.7	205,412
Dept. of Alcohol and Drug Program	3,884	10,644	228,957	207,974	20,983	10.1	228,123
Dept. of Health Services:							
Medical Assistance Program	963,328	859,146	11,053,555	12,097,910	(1,044,355)	(8.6)	10,809,306
Other Health Services	43,132	12,496	654,878	546,990	107,888	19.7	520,738
Dept. of Developmental Services	(176,860)	27,294	1,865,159	2,091,585	(226,426)	(10.8)	1,658,268
Dept. of Mental Health	188,984	74,280	519,668	481,239	38,429	8.0	545,971
Dept. of Social Services:							
SSI/SSP/IHSS	514,309	489,784	4,444,204	4,676,136	(231,932)	(5.0)	4,289,334
CalWORKs	161,839	144,860	2,304,489	2,454,461	(149,972)	(6.1)	2,661,351
Other Social Services	141,149	138,837	1,037,544	1,119,237	(81,693)	(7.3)	1,007,319
Tax Relief	153,728	154,451	600,538	630,441	(29,903)	(4.7)	594,247
Other Local Assistance	113,895	135,299	3,426,157	3,341,895	84,262	2.5	3,738,490
Total Local Assistance	**5,728,349**	**4,610,061**	**67,292,331**	**69,750,422**	**(2,458,091)**	**(3.5)**	**61,669,751**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of April		July 1 through April 30				
			2007				2006
	2007	2006	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
CAPITAL OUTLAY	**6,888**	**352,166**	**2,481,931**	**2,559,747**	**(77,816)**	**(3.0)**	**1,029,875**
NONGOVERNMENTAL (d)							
Transfer to Special Fund for Economic Uncertainties	-	-	334,993	335,123	(130)	-	-
Transfer to Budget Stabilization Account	-	-	471,770	471,770	-	-	-
Transfer to Other Funds	1,020	9	469,440	403,585	65,855	-	209,132
Transfer to Revolving Fund	97	-	(93,968)	(8,231)	(85,737)	-	75,414
Advance:							
State-County Property Tax Administration Program	-	-	-	(40,959)	40,959	-	-
Social Welfare Federal Fund	(8,382)	(22,684)	938	57,913	(56,975)	(98.4)	12,904
Tax Relief and Refund Account	-	-	-	1,000	(1,000)	(100.0)	-
Counties for Social Welfare	-	-	(664,880)	(664,880)	-	-	(560,974)
Total Nongovernmental	**(7,265)**	**(22,675)**	**518,293**	**555,321**	**(37,028)**	**(6.7)**	**(263,524)**
Total Disbursements	**$ 8,070,860**	**$ 6,998,853**	**$ 92,662,916**	**$ 94,828,046**	**$ (2,165,130)**	**(2.3)**	**$ 81,151,155**
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	$ -	$ (641,229)	$ 1,621,516	$ 1,630,130	$ (8,614)	(0.5)	$ -
Budget Stabilization Account	-	-	471,770	471,770	-	-	-
Other Internal Sources	(6,962,603)	(1,685,462)	829,483	3,322,375	(2,492,892)	(75.0)	-
Revenue Anticipation Notes	-	-	1,500,000	1,500,000	-	-	3,000,000
Net Increase / (Decrease) Loans	**$ (6,962,603)**	**$ (2,326,691)**	**$ 4,422,769**	**$ 6,924,275**	**$ (2,501,506)**	**(36.1)**	**$ 3,000,000**

See notes on page 1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through April 30			
	General Fund		Special Funds	
	2007	2006	2007	2006
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	$ 273,059	$ 260,689	$ -	$ -
Corporation Tax	8,701,592	8,405,710	-	-
Cigarette Tax	94,205	96,309	780,722	793,603
Estate, Inheritance, and Gift Tax	21,471	122,188	-	-
Insurance Companies Tax	1,730,937	1,738,321	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	2,360,866	2,377,016
Diesel & Liquid Petroleum Gas	-	-	479,869	462,964
Jet Fuel Tax	-	-	2,577	(5,665)
Vehicle License Fees	-	-	1,920,960	1,857,447
Motor Vehicle Registration and Other Fees	-	-	2,426,558	2,367,734
Personal Income Tax	44,607,458	42,399,387	748,990	700,500
Retail Sales and Use Taxes	20,762,550	21,062,645	6,340,936	5,700,717
Pooled Money Investment Interest	479,646	322,170	697	430
Total Major Taxes, Licenses, and Investment Income	**76,670,918**	**74,407,419**	**15,062,175**	**14,254,746**
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	4,097	3,690	36,476	34,934
Electrical Energy Tax	-	-	494,127	398,946
Private Rail Car Tax	6,703	6,946	-	-
Penalties on Traffic Violations	-	-	71,570	68,487
Health Care Receipts	3,983	11,074	-	-
Revenues from State Lands	225,368	224,566	-	21,430
Abandoned Property	222,733	339,300	-	-
Trial Court Revenues	53,331	48,842	1,081,190	1,006,868
Horse Racing Fees	1,771	1,812	28,398	28,450
Miscellaneous	973,613	1,266,015	5,617,313	6,552,151
Not Otherwise Classified	**1,491,599**	**1,902,245**	**7,329,074**	**8,111,266**
Total Revenues, All Governmental Cost Funds	**$ 78,162,517**	**$ 76,309,664**	**$ 22,391,249**	**$ 22,366,012**

See notes on page 1.

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2006-07 Budget Act Estimates
(Amounts in thousands)

	July 1 through April 30				
	2007				2006
	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
GENERAL FUND BEGINNING CASH BALANCE	**$ 9,232,801**	**$ 9,232,801**	**$ -**	**-**	**$ 6,436,788**
Add Receipts:					
Revenues	78,162,517	77,068,000	1,094,517	1.4	76,309,664
Nonrevenues	844,829	(96,922)	941,751	-	820,169
Total Receipts	79,007,346	76,971,078	2,036,268	2.6	77,129,833
Less Disbursements:					
State Operations	22,370,361	20,767,220	1,603,141	7.7	18,715,053
Local Assistance	67,292,331	68,782,696	(1,490,365)	(2.2)	61,669,751
Capital Outlay	2,481,931	2,665,460	(183,529)	(6.9)	1,029,875
Nongovernmental	518,293	365,093	153,200	42.0	(263,524)
Total Disbursements	92,662,916	92,580,469	82,447	0.1	81,151,155
Receipts Over / (Under) Disbursements	(13,655,570)	(15,609,391)	1,953,821	-	(4,021,322)
Net Increase / (Decrease) in Temporary Loans	4,422,769	6,376,590	(1,953,821)	(30.6)	3,000,000
GENERAL FUND ENDING CASH BALANCE	**-**	**-**	**-**	**-**	**5,415,466**
Special Fund for Economic Uncertainties (b)	-	-	-	-	641,228
TOTAL CASH	**$ -**	**$ -**	**$ -**	**-**	**$ 6,056,694**

BORROWABLE RESOURCES					
Available Borrowable Resources	$ 18,171,708	$ 16,262,609	$ 1,909,099	11.7	$ 14,678,571
Outstanding Loans (c)	4,422,769	6,376,590	(1,953,821)	(30.6)	3,000,000
Unused Borrowable Resources	$ 13,748,939	$ 9,886,019	$ 3,862,920	39.1	$ 11,678,571

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) Statement of Estimated Cash Flow for the 2006-07 fiscal year prepared by the Department of Finance for the Budget Act of 2006. Any projections or estimates are set forth as such and not as representations of fact.
(b) The Special Fund for Economic Uncertainties amount in the actual column does not include amounts in the Budget Stabilization Account.
(c) Outstanding loan balance of $4.4 billion is comprised of $2.9 billion of internal borrowing and $1.5 billion in external borrowing.
(d) Negative balances are the result of repayments received that are greater than disbursements made.
(e) Includes School Facility Aid Program that was previously displayed separately.

SCHEDULE OF CASH RECEIPTS
(Amounts in thousands)

	Month of April		July 1 through April 30				
			2007				2006
	2007	2006	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	$ 22,063	$ 22,162	$ 273,059	$ 265,000	$ 8,059	3.0	$ 260,689
Corporation Tax	1,629,502	1,733,002	8,701,592	8,365,000	336,592	4.0	8,405,710
Cigarette Tax	6,632	8,433	94,205	100,000	(5,795)	(5.8)	96,309
Estate, Inheritance, and Gift Tax	3,086	1,454	21,471	-	21,471	-	122,188
Insurance Companies Tax	468,707	489,971	1,730,937	1,821,000	(90,063)	(4.9)	1,738,321
Personal Income Tax	12,178,910	11,443,382	44,607,458	43,313,000	1,294,458	3.0	42,399,387
Retail Sales and Use Taxes	564,250	883,878	20,762,550	21,393,000	(630,450)	(2.9)	21,062,645
Pooled Money Investment Interest	38,617	50,082	479,646	406,000	73,646	18.1	322,170
Not Otherwise Classified	101,664	86,691	1,491,599	1,405,000	86,599	6.2	1,902,245
Total Revenues	**15,013,431**	**14,719,055**	**78,162,517**	**77,068,000**	**1,094,517**	**1.4**	**76,309,664**
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfers from Other Funds	7,885	9,745	212,427	(529,760)	742,187	-	276,628
Miscellaneous	12,147	12,210	632,402	432,838	199,564	46.1	543,541
Total Nonrevenues	**20,032**	**21,955**	**844,829**	**(96,922)**	**941,751**	**-**	**820,169**
Total Receipts	**$ 15,033,463**	**$ 14,741,010**	**$ 79,007,346**	**$ 76,971,078**	**$ 2,036,268**	**2.6**	**$ 77,129,833**

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS
(Amounts in thousands)

	Month of April		July 1 through April 30				
			2007				2006
	2007	2006	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
STATE OPERATIONS (d)							
Legislative/Judicial/Executive	$ 68,718	$ 105,401	$ 1,241,314	$ 1,294,834	$ (53,520)	(4.1)	$ 1,183,480
State and Consumer Services	29,342	36,957	508,612	490,558	18,054	3.7	443,189
Business, Transportation and Housing	(27)	(172)	5,414	5,128	286	5.6	4,923
Resources	118,741	16,251	1,035,644	847,817	187,827	22.2	687,388
Environmental Protection Agency	4,591	3,702	51,505	40,146	11,359	28.3	46,009
Health and Human Services:							
Health Services	22,444	(560)	228,745	225,751	2,994	1.3	226,712
Mental Health Hospitals	61,601	45,398	717,475	826,290	(108,815)	(13.2)	627,089
Other Health and Human Services	29,023	42,166	584,242	396,457	187,785	47.4	594,941
Education:							
University of California	343,290	311,640	2,911,796	2,817,779	94,017	3.3	2,800,728
State Universities and Colleges	252,723	227,778	3,002,491	2,244,164	758,327	33.8	2,029,704
Other Education	9,769	7,710	134,042	140,704	(6,662)	(4.7)	131,440
Dept. of Corrections and Rehabilitation	700,300	594,179	7,032,301	6,643,924	388,377	5.8	5,954,597
General Government	110,531	80,218	1,687,972	1,148,806	539,166	46.9	1,035,140
Public Employees Retirement System	253,504	273,060	285,144	233,535	51,609	22.1	275,343
Debt Service	338,338	315,568	2,919,656	3,410,098	(490,442)	(14.4)	2,677,179
Interest on Loans	-	5	24,008	1,229	22,779	1,853.5	(2,809)
Total State Operations	**2,342,888**	**2,059,301**	**22,370,361**	**20,767,220**	**1,603,141**	**7.7**	**18,715,053**
LOCAL ASSISTANCE (d)							
Public Schools - K-12	2,957,216	1,979,774	33,777,981	33,983,597	(205,616)	(0.6)	28,794,531
Community Colleges	300,301	233,490	3,777,783	3,757,913	19,870	0.5	2,975,002
Contributions to State Teachers' Retirement System	120,351	117,262	958,573	958,574	(1)	-	1,081,064
Other Education (e)	231,776	175,764	2,415,825	2,419,006	(3,181)	(0.1)	2,560,595
Dept. of Corrections and Rehabilitation	11,317	56,680	227,020	185,564	41,456	22.3	205,412
Dept. of Alcohol and Drug Program	3,884	10,644	228,957	265,769	(36,812)	(13.9)	228,123
Dept. of Health Services:							
Medical Assistance Program	963,328	859,146	11,053,555	11,958,894	(905,339)	(7.6)	10,809,306
Other Health Services	43,132	12,496	654,878	487,015	167,863	34.5	520,738
Dept. of Developmental Services	(176,860)	27,294	1,865,159	2,030,687	(165,528)	(8.2)	1,658,268
Dept. of Mental Health	188,984	74,280	519,668	882,585	(362,917)	(41.1)	545,971
Dept. of Social Services:							
SSI/SSP/IHSS	514,309	489,784	4,444,204	4,478,101	(33,897)	(0.8)	4,289,334
CalWORKs	161,839	144,860	2,304,489	2,313,982	(9,493)	(0.4)	2,661,351
Other Social Services	141,149	138,837	1,037,544	1,105,440	(67,896)	(6.1)	1,007,319
Tax Relief	153,728	154,451	600,538	559,070	41,468	7.4	594,247
Other Local Assistance	113,895	135,299	3,426,157	3,396,499	29,658	0.9	3,738,490
Total Local Assistance	**5,728,349**	**4,610,061**	**67,292,331**	**68,782,696**	**(1,490,365)**	**(2.2)**	**61,669,751**

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)
(Amounts in thousands)

	Month of April		July 1 through April 30				
			2007				2006
	2007	2006	Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
CAPITAL OUTLAY	**6,888**	**352,166**	**2,481,931**	**2,665,460**	**(183,529)**	**(6.9)**	**1,029,875**
NONGOVERNMENTAL (d)							
Transfer to Special Fund for Economic Uncertainties	-	-	334,993	335,123	(130)	-	-
Transfer to Budget Stabilization Account	-	-	471,770	471,770	-	-	-
Transfer to Other Funds	1,020	9	469,440	73,600	395,840	-	209,132
Transfer to Revolving Fund	97	-	(93,968)	-	(93,968)	-	75,414
Advance:							
State-County Property Tax Administration Program	-	-	-	-	-	-	-
Social Welfare Federal Fund	(8,382)	(22,684)	938	-	938	-	12,904
Tax Relief and Refund Account	-	-	-	-	-	-	-
Counties for Social Welfare	-	-	(664,880)	(515,400)	(149,480)	-	(560,974)
Total Nongovernmental	**(7,265)**	**(22,675)**	**518,293**	**365,093**	**153,200**	**42.0**	**(263,524)**
Total Disbursements	**$ 8,070,860**	**$ 6,998,853**	**$ 92,662,916**	**$ 92,580,469**	**$ 82,447**	**0.1**	**$ 81,151,155**
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	$ -	$ (641,229)	$ 1,621,516	$ 1,630,130	$ (8,614)	(0.5)	$ -
Budget Stabilization Account	-	-	471,770	471,770	-	-	-
Other Internal Sources	(6,962,603)	(1,685,462)	829,483	2,774,690	(1,945,207)	(70.1)	-
Revenue Anticipation Notes	-	-	1,500,000	1,500,000	-	-	3,000,000
Net Increase / (Decrease) Loans	**$ (6,962,603)**	**$ (2,326,691)**	**$ 4,422,769**	**$ 6,376,590**	**$ (1,953,821)**	**(30.6)**	**$ 3,000,000**

See notes on page 1.

(Concluded)

APPENDIX B

DTC AND THE BOOK-ENTRY SYSTEM

The information in the following section entitled "DTC's Book-Entry System" has been provided by DTC for use in securities offering documents. The State and the Underwriters take no responsibility for the accuracy or completeness thereof. The State and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners either (a) payments of interest, principal or premium, if any, with respect to the Bonds or (b) certificates representing ownership interest in or other confirmation of ownership interest in the Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Official Statement. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the bonds (the "Bonds"). The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each issue of the Bonds, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds $500 million, one certificate will be issued with respect to each $500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, ("NSCC," "FICC," "MBSCC" and "EMCC," also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds. DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Bonds. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State Treasurer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, Agent, or the State Treasurer, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

If the State Treasurer determines not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Bonds and the State Treasurer does not select another qualified securities depository, the State will deliver physical Bond certificates to the beneficial owners. The Bonds may thereafter be transferred upon the books of the State Treasurer by the registered owners, in person or by authorized attorney, upon surrender of Bonds at the Office of the State Treasurer in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the State Treasurer and upon payment of any charges provided for in the Resolutions. Certificated bonds may be exchanged for Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the State Treasurer in Sacramento, California, upon payment of any charges provided for in the Resolutions. No transfer or exchange of Bonds will be made by the State Treasurer during the period between the record date and the next Interest Payment Date.

Without limiting the generality of the foregoing, the State and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Bonds.

The State and the Underwriters cannot and do not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments with respect to the Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

THE STATE TREASURER, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES TO OWNERS TO ONLY DTC. ANY FAILURE OF DTC TO ADVISE ANY DTC PARTICIPANT, OR OF ANY DTC PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Bonds, payment of principal of and interest and other payments with respect to the Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS OF THE BONDS (OTHER THAN UNDER THE CAPTION “TAX MATTERS” HEREIN) SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX C

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this "Disclosure Certificate") is executed as of _____________, 2007, by the Treasurer of the State of California (the "State Treasurer") in connection with the issuance of $___________ aggregate principal amount of the State of California Various Purpose General Obligation Bonds (the "Bonds") as authorized by various acts of the State of California legislature (the "Acts"). The Bonds are being issued pursuant to resolutions of finance committees (the "Resolutions"), created or designated under the Acts. Pursuant to the Resolutions, the State Treasurer, on behalf of the State of California (the "State"), covenants and agrees as follows:

Section 1. Nature of the Disclosure Certificate. This Disclosure Certificate is executed for the benefit of the Holders and Beneficial Owners (as defined below) of the Bonds from time to time, and in order to assist the Participating Underwriters (as defined below) in complying with the Rule (as defined below), but shall not be deemed to create any monetary liability on the part of the State or the State Treasurer to any other persons, including Holders or Beneficial Owners of the Bonds based on the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with this Disclosure Certificate shall be an action to compel performance of any act required hereunder.

Section 2. Definitions. In addition to the definitions set forth in the Resolutions, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Beneficial Owner" shall mean any person who has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

"Central Post Office" means the DisclosureUSA website maintained by the Municipal Advisory Council of Texas or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission (the "SEC") as an intermediary through which issuers may, in compliance with the Rule, make filings required by this Disclosure Certificate.

"Dissemination Agent" shall mean the State Treasurer, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the State Treasurer.

"Holder" shall mean any person listed on the registration books of the State Treasurer as the registered owner of any Bonds.

"Listed Event" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository certified by the SEC to be the recipient of information of the nature of the Annual Reports required by this Disclosure Certificate.

"Official Statement" shall mean the official statement relating to the Bonds, dated __________, 2007.

"Participating Underwriter" shall mean any original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

"Repository" shall mean each National Repository and the State Repository, if any.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the reports of material events required by this Disclosure Certificate and recognized as such by the SEC. As of the date of this Disclosure Certificate, there is no State Repository.

Section 3. Provision of Annual Reports.

(a) The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the Bonds are outstanding, commencing with the report to be filed on or before April 1, 2008 containing 2006-07 Fiscal Year financial information, provide an Annual Report consistent with the requirements of this Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery. The State reserves the right to make this filing through the Central Post Office.

(b) If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

(c) If the Dissemination Agent is not the State Treasurer, the Dissemination Agent shall:

1. determine each year prior to the date for filing the Annual Report the name and address of each Repository then certified by the SEC;

2. file a report with the State Treasurer certifying that the Annual Report has been filed pursuant to this Disclosure Certificate and listing all the Repositories with which it was filed and the dates of the filings; and

3. take any other actions mutually agreed to between the Dissemination Agent and the State Treasurer.

Section 4. Content of Annual Reports. The Annual Report shall contain or include by reference the following:

(a) The audited Basic Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to this Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations; including updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—CURRENT STATE BUDGET" in the Official Statement:

Table Entitled

Statement of Revenues, Expenditures, and Changes in Fund Balance—General Fund

Major General Fund Revenue Sources and Expenditures

(c) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—STATE DEBT TABLES" in the Official Statement.

Table Entitled

Outstanding State Debt

Authorized and Outstanding General Obligation Bonds

General Obligation and Lease Revenue Bonds—Summary of Debt Service Requirements

Schedule of Debt Service Requirements for General Fund—Non-Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for General Fund—Non-Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Enterprise Fund—Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund—Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund—Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Lease-Purchase Debt

State Public Works Board and Other Lease-Purchase Financing Outstanding Issues

State Agency Revenue Bonds and Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents that have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Section 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the State Treasurer, on behalf of the State, shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. principal and interest payment delinquencies;

2. non-payment related defaults;

3. modifications to rights of Holders;

4. optional, contingent or unscheduled bond calls;

5. defeasances;

6. rating changes;

7. adverse tax opinions or events affecting the tax-exempt status of the Bonds;

8. unscheduled draws on debt service reserves reflecting financial difficulties;

9. unscheduled draws on credit enhancements reflecting financial difficulties;

10. substitution of credit or liquidity providers, or their failure to perform; or

11. release, substitution or sale of property securing repayment of the Bonds.

The State Treasurer notes that items [8, 9, 10 and 11] are not applicable to the Bonds.

(b) The State Treasurer shall timely file a notice of the occurrence of a Listed Event, which is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository.

(c) The State reserves the right to make such notice of significant event filings through the Central Post Office.

Section 6. Termination of Reporting Obligation. The State's obligations under Section 3, 4 and 5 of this Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the outstanding Bonds. If such termination occurs prior to the final maturity of the Bonds, the State Treasurer shall give notice of such termination in the same manner as for a Listed Event under Section 5(b).

Section 7. Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent.

The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the State Treasurer pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the State Treasurer may amend or waive any provision of this Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Section 3(a), 4, 5(a), or 8, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of 60% of the Bonds outstanding or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds. The State also may amend this Disclosure Certificate without approval by the Holders to the extent permitted by rule, order or other official pronouncement of the SEC.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the State Treasurer shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the State. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(b), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the State Treasurer shall not have any obligation under this Disclosure Certificate to update such information or include it in any Annual Report or future notice of occurrence of a Listed Event.

Section 10. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity (except the right of the Dissemination Agent or any Holder or Beneficial Owner to enforce the provisions of this Disclosure Certificate on behalf of the Holders). This Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

Section 11. Partial Invalidity. If any one or more of the agreements or covenants or portions thereof required hereby to be performed by or on the part of the State Treasurer shall be contrary to law, then such agreement or agreements, such covenant or covenants or such portions thereof shall be null and void and shall be deemed separable from the remaining agreements and covenants or portions thereof and shall in no way affect the validity hereof, and the Holders of the Bonds shall retain all the benefits afforded to them hereunder. The State Treasurer hereby declares that he would have executed and delivered this Disclosure Certificate and each and every other article, section, paragraph, subdivision, sentence, clause and phrase hereof irrespective of the fact that any one or more articles, sections, paragraphs, subdivisions, sentences, clauses or phrases hereof or the application thereof to any person or circumstance may be held to be unconstitutional, unenforceable or invalid.

Section 12. Governing Law. The laws of the State of California shall govern this Disclosure Certificate, the interpretation thereof and any right or liability arising hereunder. Any action or proceeding to enforce or interpret any provision of this Disclosure Certificate shall be brought, commenced or prosecuted in Sacramento County, California.

IN WITNESS WHEREOF, the State Treasurer has executed this Disclosure Certificate as of the date first above written.

By ______________________________________

A Deputy State Treasurer
For State Treasurer, Bill Lockyer

APPENDIX D

PROPOSED FORMS OF LEGAL OPINIONS

FORM OF FINAL OPINION OF EACH CO-BOND COUNSEL

[Closing Date]

$2,500,000,000*
State of California
Various Purpose General Obligation Bonds

(Final Opinion)

We have acted as Co-Bond counsel in connection with the issuance by the State of California (the "State") of $___________ aggregate principal amount of State of California Various Purpose General Obligation Bonds, dated June 1, 2007, issued as ten separate series under eight bond acts identified in Schedule A hereto (the "Bonds"). The Bonds are authorized pursuant to the respective bond acts identified in Schedule A (collectively, the "Laws") and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the "Resolutions") adopted by the respective finance committees created or designated under the Laws.

In such connection, we have examined the Resolutions, the tax certificate of the State (the "Tax Certificate"), other certifications of the State and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all documents and the signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions and the Tax Certificate, including (without limitation) agreements and covenants compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes.

We call attention to the fact that the rights and obligations under the Bonds, the Resolutions and the Tax Certificate may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations on legal remedies against the State. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

*Preliminary, subject to change.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The State has lawful authority for the issuance of the Bonds, and the Bonds constitute valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State are pledged to the punctual payment of the principal of and interest on the Bonds as the principal and interest become due and payable.

2. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the Bonds is not a specific preference item for purposes of calculating the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings in calculating corporate alternative minimum taxable income. We express no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Very truly yours,

Schedule A

- $157,115,000* principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds, Series X, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (the Villaraigosa-Keeley Act).

- $20,385,000* principal amount of State of California Library Construction and Renovation Bonds, Series K, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

- $176,840,000* principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series AC, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

- $17,490,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series AE, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $115,130,000* principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds, Series N, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

- $230,020,000* principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds, Series L, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

- $55,905,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series AF, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $242,055,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series S, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

- $1,450,060,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series R, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

- $35,000,000* principal amount of State of California Children's Hospital Bonds, Series D, authorized by the Children's Hospital Bond Act Finance Committee under the Children's Hospital Bond Act of 2004.

*Preliminary, subject to change.

FORM OF OPINION OF THE ATTORNEY GENERAL

[Closing Date]

The Honorable Bill Lockyer
State Treasurer
Sacramento, California

$2,500,000,000*
State of California
Various Purpose General Obligation Bonds

Final Opinion

Honorable Bill Lockyer:

We have acted as counsel to the State of California (the "State") in connection with the issuance by the State of $___________ aggregate principal amount of State of California Various Purpose General Obligation Bonds, dated June 1, 2007, issued as ten separate series under eight bond acts identified in Schedule A hereto (the "Bonds"). The Bonds are authorized pursuant to the Bond Acts identified in Schedule A (collectively, the "Laws") and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the "Resolutions") adopted by the respective finance committees created under the Laws.

In such connection, we have examined the record of proceedings submitted to us relative to the issuance of the Bonds, including the Resolutions, certifications of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof.

We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions. We call attention to the fact that the rights and obligations under the Bonds and the Resolutions may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations contained in State law regarding legal remedies against the State. We express no opinion as to whether interest on the Bonds is excluded from gross income for federal income tax purposes or exempt from State of California personal income taxes or as to any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated ____________, 2007 or other offering material relating to the Bonds and express no opinion with respect thereto.

*Preliminary, subject to change.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that the State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State of California are pledged to the punctual payment of the principal of and interest on the Bonds, as the principal and interest become due and payable.

Sincerely,

Deputy Attorney General
For EDMUND G. BROWN JR.
Attorney General

Schedule A

$157,115,000 * principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds, Series X, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (the Villaraigosa-Keeley Act).

- $20,385,000* principal amount of State of California Library Construction and Renovation Bonds, Series K, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

- $176,840,000* principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds, Series AC, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

- $17,490,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series AE, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $115,130,000* principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds, Series N, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

- $230,020,000* principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds, Series L, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

- $55,905,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series AF, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $242,055,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series S, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

- $1,450,060,000* principal amount of State of California Kindergarten-University Public Education Facilities Bonds, Series R, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2004.

- $35,000,000* principal amount of State of California Children's Hospital Bonds, Series D, authorized by the Children's Hospital Bond Act Finance Committee under the Children's Hospital Bond Act of 2004.

---

*Preliminary, subject to change.